VETERANS' ADMINISTRATION HOME LOAN GUARANTY PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND MEMORIAL AFFAIRS

OF THE

COMMITTEE ON VETERANS' AFFAIRS
HOUSE OF REPRESENTATIVES

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VETERANS' ADMINISTRATION HOME LOAN GUARANTY PROGRAM

THURSDAY, MARCH 17, 1988

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS,
COMMITTEE ON VETERANS' AFFAIRS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 340, Cannon House Office Building, Hon. Marcy Kaptur (chairman of the subcommittee) presiding.

Present: Representatives Kaptur, Patterson and Burton.

OPENING STATEMENT OF CHAIRWOMAN MARCY KAPTUR

Miss KAPTUR. The subcommittee will be in order.

Last year, as a result of extensive hearings, our committee and the Congress passed the most major veterans' housing reform bill since the inception of the Home Loan Guaranty Program. The provisions were designed in such a way so as to benefit both veterans and the operation of the program. Unfortunately, prior to the implementation of many of these provisions, we are today faced with a very serious financial problem within the loan guaranty fund.

We were advised a month ago that a supplemental in the amount of over one-half billion dollars, in the amount of $526.6 million, was forthcoming, and that without it the revolving fund could be depleted as early as April 1. The supplemental has yet to arrive from the Office of Management and Budget.

Additionally, last year's economic summit agreement imposed a formula for the disposition of the VA's loan portfolio. In other words, a formula was set up so that the VA could only sell loans so as to maximize potential returns, yet the President's budget document seemingly ignores this formula by emphasizing that loan sales for the remainder of this fiscal year would be without recourse.

I strongly believe in the beneficial aspects of this program, as do the members of this committee, and we wish to reiterate, as many of our witnesses do in their testimony, that this is a benefit program. I don't think that the program was necessarily intended to be totally solvent in the business sense. However, this does not mean that it should not be run in a fiscally prudent manner at the same time.

As you know, unless we receive a supplemental request from the Office of Management and Budget on behalf of the administration, we cannot act. Although this is a formal hearing, I would like you

to think of it as a working meeting so that we may take a fresh approach in attempting to solve the financial problems currently being experienced by the program.

Before I call our first panel, I would like to recognize the ranking minority member of the subcommittee, Mr. Burton.

OPENING STATEMENT OF HON. DAN BURTON

Mr. BURTON. Thank you, Madam Chairwoman.

The subject matter before us this morning is of great importance. We seek to find ways to gain control over the huge expenditures by the Veterans' Administration in the loan guaranty housing foreclosure program. At this very moment, the VA is almost out of money to pay any claims. The Congress awaits a request for a supplemental appropriation of over $525 million to carry VA through the end of this fiscal year, at which time it will begin to spend an additional huge sum in the next fiscal year.

We have been told that we will shortly receive a credit reform proposal that concerns not only the VA Home Loan Program but the entire Government. The VA's share of up-front money to pay claims will be well over $1 billion. We don't know the details of this proposal, but it is safe to say that the Congress will be taking a hard and cautious look at it. Certainly that will be true of this subcommittee.

Madam Chairwoman, as we seek to come to grips with this Government-wide problem, I know you will agree that we don't want to do harm to the basic GI loan program, which is an extremely good one.

Madam Chairwoman, you have described this hearing as a working meeting, designed to take a fresh look and a fresh approach to the situation of the VA. I join with you in this endeavor and look forward to hearing our witnesses this morning.

Thank you, Madam Chairwoman.

Miss KAPTUR. Thank you, Mr. Burton. As always, it is a pleasure to work with you.

I wanted to mention to all of the people who have traveled from afar to be with us today, we appreciate your attendance and we will read your testimony. Believe me, I will look at it very carefully for ideas and recommendations.

Today we face an unusual situation here in the Congress because of the situation in Honduras. There is a special briefing set up for Members at 11:30. It was not our intention to have such restricted time this morning. However, I know that all of our members will want to attend that, and so I would ask—we have four panels of witnesses this morning—in order to use the time most efficiently, we are going to divide you, allow each panel approximately 20 minutes.

Therefore, I would ask that when you approach the table we will take your testimony, and we will insert the complete testimony in the record. We would like you to use your time, 5 minutes each, in summarizing a basic statement and your recommendations, which is really what we are looking for here this morning, and that will allow us a little time for questions.

I would like to call the first panel from the Veterans' Administration: Mr. R.J. Vogel, Chief Benefits Director, accompanied by Mr. Keith Pedigo, Director of the Loan Guaranty Service, and Mr. James P. Kane, Assistant General Counsel; and from the United States General Accounting Office, Mr. John Luke, Associate Director of Resources, Community and Economic Development Division, accompanied by Mr. Edward Kratzer, Group Director, and Mr. Luther Atkins GAO Evaluator.

We really welcome all of you gentlemen here, and I believe I am supposed to recognize someone else who is sitting out there. Mr. Grady Horton will be speaking this morning in place of Mr. Kane from the Veterans' Administration.

We welcome all of you today. Why don't we begin with Mr. Vogel?

STATEMENT OF R. J. VOGEL, CHIEF BENEFITS DIRECTOR, VETERANS ADMINISTRATION, ACCOMPANIED BY R. KEITH PEDIGO, DIRECTOR, LOAN GUARANTY SERVICE; AND GRADY HORTON, DEPUTY CHIEF BENEFITS DIRECTOR FOR PROGRAM MANAGEMENT

Mr. VOGEL. Thank you, Madam Chairwoman.

Miss KAPTUR. Thank you. Sorry to put you on such a tight time schedule, but you know this program as well as anyone else.

Mr. VOGEL. We will roll through it as fast as we can.

Happy St. Patrick's Day.

Miss KAPTUR. Happy St. Patrick's Day to you, too.

Mr. VOGEL. It is a pleasure to appear before you this morning to discuss the operation of the VA's housing program. I would like to bring you up-to-date on the current activity level of the Loan Guaranty Program.

A period of economic stability has permitted the VA to keep the interest rate on guaranteed home loans at fairly stable rates. The current rate is 9 and a half percent and was effective February 1. During 1987 the VA guaranteed 455,616 loans, which is the highest since 1956. Due to the lower interest rates of the past 2 years, refinancing loans approximated 39 percent of the total loan volume for 1986 and 1987. Over 75 percent of the acquisition loans in 1987 were made without a down payment.

Since the Loan Guaranty Program was enacted in 1944, it has assisted over 12.4 million veterans to obtain housing. Mortgage credit totaling $306 billion has been allocated to veterans. Over $125 billion worth of those loans have been repaid in full as of last year.

Madam Chairwoman, we are continuing to experience a large number of GI loan defaults. As a result, there were 140,558 loans reported as being delinquent as of December 31, 1987, an increase of 5.4 percent over the 133,333 pending as of December 31, 1986. We paid 34,750 claims in calendar year 1986. This increased 25.8 percent to 43,725 claims paid in calendar year 1987.

One provision of the Deficit Reduction Act of 1984 was the requirement that at least 25 percent of our properties be sold for cash. Public Law 100-198 increased the minimum requirement to 35 percent. The percentage of properties sold for cash during fiscal year 1988, through February, was 38.24 percent.

After a significant inventory reduction in fiscal year 1985, the nationwide inventory experienced a net increase of about 2,000 properties in fiscal year 1986 and another 2,000 in fiscal year 1987. Property sales during fiscal year 1987 set an all-time record for sales during any fiscal year. The fiscal year 1987 sales record exceeded the previous record set in fiscal year 1965 by 22.5 percent.

The lack of an overall substantial reduction in inventory during fiscal years 1986 and 1987 might give the impression that our nationwide sales effort has been slow. In fact, the record sales show we have been working vigorously at reducing our property inventory.

In large part, our property sales problems are still located in the "Energy Belt." For example, if three regional offices—Denver, Muskogee, and Houston—had just been able to stay even by selling the same number of properties that were acquired, the sales results of the remaining 46 regional offices would have given us a net inventory reduction of 5,273 properties. Those three stations now account for over a third of the VA's on-hand inventory.

These are hard-hit real estate markets with record levels of foreclosures and properties available for sale in all sectors of the market. Under these conditions, we can't pretend to have found the most effective marketing strategies which others in similar circumstances haven't yet found. We have begun to see higher property sales and purchase offers in the Houston area. With the removal of the mandatory down payment requirements, we are hopeful that the trend will continue.

We continue to acquire properties in the economically depressed areas because the level of loan terminations remains high. Among those liquidated there are still numerous instances in which, after considering estimated property acquisition and disposition costs, the net value of the property indicates acquisition to be in the best interest of the Government.

We project a gradual decline in property inventory over the next few fiscal years. Our regional offices have been successful in selling over 60,000 properties in the last 2 years and reducing the holding time markedly. Our efforts to dispose of inventory property will continue to be based on timely pricing revisions, increased advertising, and more effective cooperation with real estate professional groups. The agency's inventory reduction goals have been included in the performance standards of all of our regional office directors.

Our implementation of Public Laws 100–198 and 100–253 is on track. Instructional material has been sent to our regional offices and program participants on the requirements for a down payment on manufactured homes, the new refinancing provisions, the revised occupancy requirements, and the new requirements for VA-guaranteed loans that are assumed. We are writing the regulations to implement all the requirements of those two public laws now.

Public Law 100–198 also authorized us to sell VA-acquired properties for use as shelters for homeless veterans; to sell acquired properties to employers who use veterans in a program of job training; to provide priority to veterans in the purchase of properties rehabilitated under the program; and to include in a VA-provided loan to finance a VA-acquired property, an amount to be used for rehabilitation.

To implement, the homeless program we propose to offer discounts up to 35 percent to those eligible to purchase properties under the program. To implement the job training program, we propose to make properties which have been on hand for 12 months or more (and which are available in an "as is" condition) eligible for cash sale. Discounts offered to approved purchasers will be 25 percent of the minimum acceptable prices for those properties. You can see that we are on the way towards implementing all the provisions of that law.

Your invitation letter mentioned several areas you intend to explore. I would like to offer some brief comments on those.

We performed a very general review of mortgage insurance, including the programs of HUD and private mortgage insurers. We are in the process of making a more detailed analysis of the feasibility of using mortgage insurance in the home loan benefit program by utilizing an outside contractor.

With regard to holding assets instead of selling them, we support the administration's policy which calls for timely disposal of loan assets without recourse to the Government. It would take a number of years to build up a portfolio of vendee loans with sufficient cash flow to make the revolving fund solvent. During this period greater appropriations would be necessary to support the program.

Your letter also mentions, Madam Chairwoman, the option of renting certain VA properties. It has been our experience that VA-owned properties are more easily sold if they remain unoccupied. Directors of regional offices, however, do have the authority to rent properties if rental is determined to be in the VA's best interest.

Financial considerations regarding the revolving fund have necessarily influenced decisions with respect to offering properties for rent. The commitment to meet the needs of the revolving fund and to reduce the inventory have tended to limit the exercise of that authority. A rental program would hinder VA's near-term ability to replenish the fund, since rentals do not provide the same lump sum of cash that is obtained from property sales and loan sales.

Madam Chairwoman, that concludes my statement. I would be pleased to answer any questions that you or other members of the committee may have.

[The prepared statement of Mr. Vogel appears on p. 33.]

Miss KAPTUR. Thank you, Mr. Vogel, very much. I appreciate that.

I think we are going to move right on to the General Accounting Office. Mr. Luke, were you going to testify on behalf of the office?

STATEMENT OF JOHN H. LUKE, ASSOCIATE DIRECTOR, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, UNITED STATES GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY EDWARD KRATZER, GROUP DIRECTOR; AND LUTHER ATKINS, GAO EVALUATOR

Mr. LUKE. Thank you, Madam Chairwoman, for the opportunity to appear before you again. We appeared last May, I think, and we look forward to furthering the discussion on this important subject.

Before I get started, I would like to recognize Mr. Ed Kratzer, Group Director, who heads all of our VA audit work in the housing area for the General Accounting Office; and to my right, Mr. Luther Atkins, who assists him in those audit endeavors. I will summarize my statement, Madam Chairwoman.

Miss KAPTUR. All right. I would ask you to please do that, in the interests of the other witnesses, so they can get to the table here this morning.

Mr. LUKE. Right.

As you are aware, in recent years there has been a large increase in foreclosures nationally, reportedly a 100 percent increase over the past 7 years. In some parts of the country the rate has increased several-fold. As a result, both private mortgage insurers and Federal mortgage insurers, including VA, began to experience increased claims against their insurance funds.

For example, in fiscal year 1987 the VA had over 42,000 foreclosures and lost about $465 million in the sale of the foreclosed properties, up from 33,000 foreclosures and a loss of $356 million in fiscal year 1986. Thus, on September 29, 1987 the chairman of the Veterans' Affairs Committee asked GAO to review several aspects of the VA Home Loan Guaranty Program, including activities related to loan servicing, property management, and debt collection, as well as the characteristics of the loans contained in VA's portfolio and VA's future plans to sell those loans.

Our work in each of these areas is continuing. As agreed, my remarks today, summary remarks, will focus basically on the servicing aspects of VA activities. Specifically, they will address VA's servicing requirements for lenders and how VA monitors lender servicing activities; how VA's supplemental servicing activities can be improved; and the adequacy of VA's staffing to provide effective servicing.

In summary, when a VA-guaranteed loan becomes delinquent, VA requires lenders to contact the veteran to determine the reason for the delinquency and to work with the veteran in solving the problem. VA has a system for monitoring the lender's servicing activities. However, our review to date indicates that VA officials believe that the lender monitoring system could be improved by conducting on-site audits of lender servicing activities.

Further, even though VA has recently emphasized to its regional offices the use of foreclosure alternatives—refunding, compromise sales, and deed in lieu of foreclosure—our review shows that VA has not extensively used these alternatives. Although foreclosure alternatives have the potential to substantially reduce VA losses, at the VA offices we contacted, alternatives were used in only 2.5 percent of the foreclosure cases.

VA could better ensure that its foreclosure costs are being held to a minimum by requiring that a least cost analysis of the foreclosure alternatives be prepared and documented for each foreclosure case. Finally, based on interviews with representatives of the VA regional offices, VA's staffing is reportedly inadequate to effectively contact, counsel, and assist the large number of veterans having delinquent loans.

The large increase in claims over the past few years has prompted private mortgage insurers to work more directly with borrowers

in developing financial plans to determine the best solution for curing delinquencies. In addition, lenders told us that the PMI's are more helpful in resolving delinquencies partially because they get involved about 30 days earlier in the foreclosure process than does VA. PMI officials told us that companies conduct on-site reviews of the lender's servicing activities and actively assist the homeowners in selling their homes to prevent foreclosure.

As we reported in our May, 1987 testimony, VA offices generally did not provide information on VA foreclosure activities unless veterans were aware of and requested such information. In December, 1987 the Congress passed the Veterans Home Loan Program Improvements and Property Rehabilitation Act of 1987, which now requires VA to provide information to defaulting veterans on the alternatives to foreclosure. This requirement should encourage more contact between VA and veterans, which could increase the use of alternatives to foreclosure.

However, our work shows that VA regional offices have a great deal of latitude in determining how to deal with the delinquencies, and as of today no procedures are in place requiring VA offices to analyze and document a least cost approach for addressing these delinquencies. Although VA maintains that its offices consider foreclosure alternatives in handling each default, VA has not developed and documented a least cost analysis that compares the cost of the various alternatives. Such an analysis should be considered in determining the costs of various foreclosure alternatives, including the Government's interest costs and the probability of collecting on any deficiency that the veteran may have.

I will stop here, Madam Chairwoman, and we are available to respond to any questions that you may have at this time.

[The prepared statement of Mr. Luke appears on p. 47.]

Miss KAPTUR. All right, Mr. Luke. We appreciate your brevity this morning.

I would like to call on Mr. Burton for any questions of either of the witnesses.

Mr. BURTON. Thank you, Madam Chairwoman.

I have just one question. I will have a number of other questions I would like to submit for the record and if you could respond to those in writing, we would appreciate it.

I used to work, before I came to Congress, in real estate. We handled some welfare and VA properties from time to time, and there was a lot of vandalism and destruction. Many times we had a welfare property that was ready for sale, and before we could get the thing closed, somebody would go in an vandalize it or burn it down. Have you experienced that, and to what degree?

Mr. VOGEL. We have, Mr. Burton. As a matter of fact, it was publicized recently in the Houston paper about vandalization of properties.

We have brokers assigned on a fee basis to manage properties, and we expect them to do what they can to keep them secure, to identify problems with vandalization, to work with the local community. We have property management personnel, realty specialists in our Loan Guaranty Division, who work with those brokers. We have about 400 individuals nationally assigned to our regional

offices to work with the hundreds and hundreds of brokers who handle the thousands and thousands of properties.

That is a long answer to a short question. We do have that problem in some areas.

Mr. BURTON. Well, if you could, maybe right now you wouldn't have the figures before you but I would be interested in knowing what percentage of the properties that are in foreclosure are vandalized and what the dollar cost is to the taxpayer.

Mr. VOGEL. We will do what we can to develop that for you, Mr. Burton.

Mr. BURTON. Well, I hope you will do better than that. Surely you have records around someplace.

Mr. VOGEL. Maybe Mr. Pedigo can respond.

Mr. PEDIGO. Well, Mr. Burton, as a matter of fact we don't maintain those types of records on a systematic basis, because there are differing degrees of vandalism. Some properties are broken into and no damage is done other than to destroy the lock on the front door. In other instances properties are totally vandalized, but we don't maintain——

Mr. BURTON. Well, I know that we have a lot of things we have to go through today, but whenever there is damage done to a property, it costs something to repair it. If the property is totally destroyed, you know what the value of the property was, and you surely must have records someplace on that. I would really like to, as close as you can approximate the loss, I would like to know, and what can be done to minimize that.

Thank you.

[Subsequently, the Veterans' Administration submitted the following information:]

At one time, records of property expenses were maintained by type of expense. The categories of expenses included initial repairs made to properties, repairs made at VA's expense after properties were sold, routine maintenance and repairs to preserve properties, and repairs made to restore properties in cases of destruction. While this latter category included restoration of properties which were damaged by vandals, it also included repairs which were made as a result of damage caused by fire, windstorms, floods, or other hazards. Dollar entries in this category included expenditures for any repairs made as a result of destruction.

Loan Guaranty field personnel no longer segregate repair costs by category. They are instead categorized as capital or non capital expenses. Even if the old system were still maintained, costs for repairs made as a result of vandalism to properties would not be a separate entry within the category of "repairs necessitated by destruction."

Miss KAPTUR. Thank you, Mr. Burton.

I must say that in both of the testimonies I was looking for a little more information about what we do if we do not get this supplemental, and with the fund a half billion dollars in the red, what that means to us this year. I would ask each of you gentlemen representing the Veterans' Administration, if you could send the committee a letter, after you go back and you perhaps get copies of the other testimony that is going to be delivered today by the other witnesses. If we do not get a request for the supplemental, what does that mean to the future of this program this year? Mr. Vogel, you did not say anything about that in your testimony. I was hoping to hear a little bit.

Mr. VOGEL. Madam Chairwoman, absent a supplemental, we would begin to close the program down, literally. We would not be

able to pay claims. We would begin, probably, with delaying the payments of claims. What I mean by "delay" is, whatever monies are available, funds are available from sales and other infusions into the revolving fund, ultimately slow that down to a point and then not be able to make the claims payments.

I understand that the supplemental has been in OMB for some time now, since early January.

Miss KAPTUR. That is correct.

Mr. VOGEL. I understand that, as of this morning, that they expected to have it out within a day or so, but I said the same sort of thing a couple of weeks ago, too. We are in a critical position, no question about that.

Miss KAPTUR. I understand that, Mr. Vogel, and I think one of the things I would appreciate, that I would share with members of the committee, if you could just send us a two-page letter that, if in fact we do not receive a supplemental, what would be the first 10 things that would happen within the Veterans' Administration regarding this program. I think we would be very interested in knowing the constraints that you are under.

Mr. VOGEL. Yes, we would be pleased to provide that, Madam Chairwoman.

Miss KAPTUR. All right. Very good.

Mr. LUKE. Madam Chairwoman, if I may——

Miss KAPTUR. As quickly as we can get that, it would be very helpful to us.

[The following material subsequently was supplied by the Veterans' Administration:]

Barring fraud or other unusual circumstances, the Administrator is obligated to pay a holder's claim under loan guaranty in the event of a loan default if the loan was guaranteed under 38 U.S.C. 1810 or 1819.

Under 38 U.S.C. 1816, VA is also obligated to offer to purchase the property securing a GI loan guaranteed under 38 U.S.C. 1810 in connection with the foreclosure of the loan (except in no-bid cases.)

If VA were unable to meet these obligations promptly as a result of a depletion of the Loan Guaranty Revolving Fund (LGRF), the following events would occur:

1. We would consider whether the availability of funds would permit a transfer to be made from the Direct Loan Revolving Fund, Readjustment Benefits Appropriation, and the Compensation and Pensions and Veterans Insurance and Indemnities Appropriations into the LGRF.

2. We would need to put holders on notice that claims payments, property acquisitions and acceptance of custody of properties by VA would be contingent on the availability of funds.

3. Preparation of claims and acquisition vouchers would continue, but processing would be held up prior to vouchering of these items by Loan Guaranty Division.

4. Updating of loan guaranty computer systems ("claim vouchered" and "liquidation completed") would be stopped because the coding actions cause the accural of obligations. This would mean that a review of a veteran's records would not disclose the foreclosure and corresponding debt to the Government.

5. To the extent that limited funds became available from collections on VA portfolio loans, funding fees, cash sales of properties in VA's inventory, loan sales, or other sources, such funds would be allocated by VA Central Office to each field station. The Finance Officer at each station would advise the Loan Guaranty Division as to the dollar limit which could be sent to the Finance Division for payment each day.

6. Items having priority over claims and acquisitions include appraisal fees, payment on real estate taxes and property insurance on portfolio loans, and certain property management expenses related to the preservation of properties in VA's inventory.

7. We anticipate that the Department of Justice would be required to respond to litigation initiated by loan holders for payments due plus interest and damages.

Miss KAPTUR. Yes, Mr. Luke?

Mr. LUKE. We currently don't have any ongoing work in terms of alternative sources of financing for the fund, so with respect to that request, I am not quite sure what I can add to the debate at this point in time.

Miss KAPTUR. Basically what I was looking for was a description, which I think the VA could best give us, on what would be the steps that would have to be taken immediately if that supplemental were not passed. Now if the GAO has any suggestions, based on your work, of other alternative ideas that would be useful to us as we explore ways to insure this benefit program, we would certainly welcome those from you.

I wanted to ask quickly, Mr. Luke, you state that a 2 percent increase in the cure rate would reduce losses by about $55 million. How many staff people would be required in order to result in that 2 percent cure rate, for better servicing, lower delinquencies?

Mr. LUKE. I am not sure in terms of what the staff year equivalencies are with respect to achieving that $55 million. I think VA may be in a better position to respond to that because the source of that data for us was in fact the Veterans' Administration.

Miss KAPTUR. Mr. Pedigo, did you want to comment on that?

Mr. PEDIGO. Madam Chairwoman, that calculation was made by the VA, but in making the calculation we were unable to determine the exact number of additional personnel that would be needed to achieve that. Because of the nature of servicing, we are not sure at this point what the direct impact is of adding additional personnel to servicing. We only know that there is a positive impact. We will be starting a pilot program on loan servicing in our Houston regional office within the next 6 weeks that will enable us to make an assessment as to the effectiveness of putting additional personnel into servicing. That will be a 12-month program.

Miss KAPTUR. I am glad you mentioned the pilot program. You will receive a question from me on that, because it was my impression when we passed the law that we didn't ask for a pilot program but rather we asked for servicing across the VA system, and we would view the pilot program really as a subversion of congressional intent, so you are going to get a pretty strong question on that. If we had more time, I would go into that and really put you on the spot here this morning.

I have one final question for Mr. Vogel: Your last loan sale with recourse resulted in your receiving approximately 105 cents on the dollar, and you are proposing that your next three loan sales for the remainder of this year be without recourse. Usually this requires a tremendous discount. Is any consideration being given at all to the congressionally mandated formula that required you to analyze ways in which to maximize your returns?

Mr. VOGEL. I would ask Mr. Pedigo to answer that, Madam Chairwoman.

Miss KAPTUR. Mr. Pedigo?

Mr. PEDIGO. Yes, Madam Chairwoman, we plan to conduct that congressionally mandated analysis, comparing recourse with nonrecourse. We just procured the services of our underwriters, Salomon Brothers and First Boston, and we plan to use those companies

along with Kidder Peabody, who is our financial advisor, to conduct that analysis within the next 60 days.

Miss KAPTUR. First Boston, which is one of the primary underwriters that you selected, testified in late February before the Budget Committee that selling assets on a recourse basis would likely increase the Government's return, so I just wanted to put that in the record.

All right. I thank you gentlemen. I am sorry to be so brief this morning, and you will hear from us in the mail.

Mr. VOGEL. Thank you, Madam Chairwoman.

Miss KAPTUR. We want to welcome this morning from the National Association of Home Builders, Mr. Martin Perlman, their vice president and treasurer; from the Mortgage Bankers of America, Mr. Robert M. O'Toole, who is staff vice president, Residential Finance and Government Agency Relations; from the National Association of Realtors, Mr. Bob Muffley, chairman of the Government Mortgage Programs Committee; and from the National Council of Savings Institutions, Mr. James Butera, the group vice president for Legislative and Regulatory Policy.

We thank you gentlemen for being with us this morning, and we also appreciate your understanding of our time constraints. We will take your full testimony for the record, if you could just summarize any recommendations you might have or observations you would have on the solvency of the fund. That was really the purpose of the hearing this morning, and we would begin with Mr Perlman.

STATEMENT OF MARTIN PERLMAN, VICE PRESIDENT AND TREASURER, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. PERLMAN. Thank you, Madam Chairwoman, Congressman Burton, Representative Patterson.

My name is Martin Perlman. I am vice president and treasurer of the 150,000 members of the National Association of Home Builders. I am a builder from Houston, Texas and have been active in the VA Home Loan Guaranty Program for more than 20 years. Let me say that the highlight of my last year and a half of service as an elected representative of NAHB was to be present at the 12 millionth closing of a VA home in Phoenix, Arizona last year. We are proud of the partnership that we have had with the VA and the Congress in providing home ownership opportunities for veterans over the past 44 years, and I am pleased to be here today to present our views on the long-term solvency of the VA Home Loan Guaranty Program.

It is important that the VA Home Loan Guaranty Program be sustained and run in an efficient manner. We do not believe, however, that temporary increases in foreclosures or downturns in certain parts of the country should lead to cutbacks in the benefits of the program. The nature of entitlement—and that word will run throughout my testimony—is fundamentally different from traditional financing programs and requires a higher level of commitment from Congress.

Congress should focus on the long-term goals and performance of the Home Loan Guaranty Program and evaluate program changes

on that basis, since it continues to assist people it was intended to serve and it must continue to attract qualified men and women into the service. In the interim, it is important to support appropriations for the Loan Guaranty Revolving Fund and to oppose increased fees to supplement the program.

Madam Chairwoman, concerning the subcommittee's proposals, it was a pleasure for me to testify before you in Houston last July——

Miss KAPTUR. You did a good job.

Mr. PERLMAN [Continuing]. In support of renting foreclosed property as an alternative to selling homes at a loss in distressed areas. Holding the properties in the Veterans' Administration portfolio and putting them on the market for a temporary period as rental units, rather than selling them at below market, would accomplish several things: It would provide housing for citizens who cannot afford to buy, it would not disrupt the marketplace, and it would allow the Government to sell properties over time as real estate values improve.

When I testified before you last year, I was faced with the possibility of shutting down my company, Perl Homes, which unfortunately happened because I was put in the position of competing with foreclosed properties that were being sold by auction at 50 percent or more of the current sales price. While Congress has taken steps to limit auctions as a last resort, the Houston Chronicle last week reported that another VA auction will be held in the area in early April.

We are concerned that auctions and new property disposition plans being considered by Congress and the VA may again adversely affect the new home buying marketplace. The intent is to make the disposition of VA acquired properties more saleable in distressed areas, but care should be given to avoid dumping properties, which would make new home sales noncompetitive. I would share with you the article that says: "HUD/VA Said To Be Dumping Homes Here."

[See p. 74.]

Mr. PERLMAN.Madam Chairwoman, the concept of mortgage insurance is based on the principle of actuarial soundness, with premiums set at a level that will compensate an insurer for assuming the risk of borrower default. Under the VA Home Loan Guaranty Program, while the veteran must meet underwriting standards which limit the risk to the VA, the program was created as an entitlement—I repeat, an entitlement—to help the veterans buy a home. Costs would have to be substantially raised to create a mortgage insurance program.

We are concerned, as you are, with the administration's policy decision to sell loan assets of the VA and other Federal agencies. Short-term gain in deficit reduction must be balanced against the long-term losses of the income stream, in determining the actual value of the asset being sold. The loss of the income stream for the Loan Guaranty Revolving Fund only increases the pressure for additional appropriations.

Concerning the administration's budget proposals, we are pleased that the VA Committee again rejected a negotiated interest rate in recommendations made to the Budget Committee.

Madam Chairwoman, as you are aware, the pilot program for an ARM which you so ably guided through the House was dropped in conference last year. We are pleased however that you may again consider the issue of an adjustable rate mortgage for veteran home buyers. Earlier this month we testified before the Senate in support of creating an independent commission on the VA Home Loan Guaranty Program. We urge you to consider the establishment of such a commission.

Thank you for allowing us to present our views. I would be pleased to respond to any questions you may have.

[The prepared statement of Perlman appears on p. 63.]

Miss KAPTUR. Thank you, Mr. Perlman. I can tell you are a good businessman. You finished within the allotted time.

Mr. O'Toole?

STATEMENT OF ROBERT M. O'TOOLE, STAFF VICE PRESIDENT FOR RESIDENTIAL FINANCE AND GOVERNMENT AGENCY RELATIONS, MORTGAGE BANKERS ASSOCIATION OF AMERICA

Mr. O'TOOLE. MBA appreciates the opportunity to testify before your committee, Madam Chairwoman, on the solvency of the VA Home Loan Guaranty Program and ways to make the Loan Guaranty Revolving Fund more self-sustaining than it is now.

MBA shares your concern about the financial status of the fund. The fund has not been self-sustaining in the past. When it was in a deficit position, it depended on transfers from the direct loan revolving fund. However, the VA stopped making direct loans in 1981 and then sold most of the loans in the direct loan portfolio, eliminating a major source of income for the revolving fund.

The fund also benefitted in the past from inflation in home prices. In the case of foreclosures, the VA could sell properties it acquired at prices that were more than the amount of the mortgage debt. Inflation enabled the VA to recoup its expenses and protected it from losses.

The current temporary funding fee of 1 percent, which generated $341 million in fiscal year 1987, and so far, $148 million in fiscal year 1988, has been in existence for most of the 1980's but does not offset the entire cost of the Guaranty Program. The issue of alternatives to the funding fee needs to be addressed, but that cannot happen until Congress answers the basic question of whether or not it intends the program to continue as an entitlement. If Congress reaffirms the program as an entitlement, then it is incumbent upon the Congress to acknowledge that the program will require appropriations.

If Congress decides that the VA program should be changed to an actuarially sound mortgage insurance program, then the cost of the program would be borne by those veterans whose loans would be insured. The difficult issue with converting the program is that the costs for those who need the program most would increase. The MBA would like to point out that an actuarially sound VA mortgage insurance program would be very much like FHA. It is conceivable that a decision by Congress to treat the program as an insurance program in order to preserve it could in fact cause its demise.

MBA would also like to repeat its opposition to the administration's proposal to sell vendee loans in the VA loan portfolio without recourse. It is doubtful whether such nonrecourse loans could be put into pools backed by Ginnie Mae and thus, if for no other reason, the loans would be sold at very low prices which would not be in the best interests of the revolving fund.

MBA believes that efficiencies in program management could be a positive step in reducing losses. For example, inadequate staffing causes delays in foreclosure sales, which increase the amount of the veteran's indebtedness and cause unnecessary losses to the VA and also to the lender. In addition, adequate data processing support would save valuable time by allowing VA staff to perform their functions more efficiently.

MBA also believes that the VA might very well minimize its losses by renting properties it has acquired, and thinks that the feasibility of such action should be fully explored.

Madam Chairwoman, this concludes my oral statement, we appreciate the opportunity to testify.

[The prepared statement of Mr. O'Toole appears on p. 77.]

Miss KAPTUR. Thank you, Mr. O'Toole, very much for coming here today.

Mr. Muffley?

STATEMENT OF BOB J. MUFFLEY, 1988 CHAIRMAN, GOVERNMENT MORTGAGE PROGRAMS SUBCOMMITTEE, REAL ESTATE FINANCE COMMITTEE, NATIONAL ASSOCIATION OF REALTORS

Mr. MUFFLEY. Thank you, Madam Chairwoman. My name is Bob Muffley. I am a realtor from Gooding, Idaho and the 1988 chairman of the Government Mortgage Programs Subcommittee of the National Association of Realtors. On behalf of the more than 800,000 members of our association, I want to thank you and the members of this subcommittee for the opportunity to present our views on veterans' housing issues.

The National Association of Realtors believes that it is imperative for Congress to develop a formal national housing policy that provides a reasoned framework in which to address this Nation's housing needs. Home ownership is a fundamental American value, and we urge Congress to resist the temptation to accept piecemeal solutions to veterans' housing concerns.

Concerning sales versus rental of VA inventory properties, subsequent to preparing our written statement we were notified by our members that VA is holding auctions in eight States. We are gravely concerned that these auctions undermine the cooperative effort agreed upon by VA and the National Association of Realtors. In some cases auctions can be useful methods of disposing of properties. We are concerned, however, that auctions may depress home values and sales prices in markets already characterized by supply and demand imbalances. We believe that in most cases a community is better served by the sale of a home through conventional means rather than by auction.

As experts in real estate markets, local boards have effective and efficient ways of selling these properties through the multiple listing services. The properties will be available to real estate profes-

sionals throughout their communities. We believe that the experience and knowledge possessed by realtors will allow VA to reduce the number of properties they currently have in inventory and put them on an equal footing with other sellers that are currently utilizing the services of realtors. This plan also permits VA to better utilize its present staff.

We have several concerns about the effectiveness of a rental program in alleviating pressure on the Loan Guaranty Revolving Fund. When the VA acquires a property, it makes an outlay from the Loan Guaranty Revolving Fund equal to the market price plus the guaranty. If the VA rents the property, it will take years to compensate the fund for the cash disbursement. If the VA sells the property, however, the Loan Guaranty Revolving Fund is replenished immediately.

We are also concerned about the potential effects of rental programs on the local economies and on VA's ability to dispose of the properties. The economically depressed areas for which rental programs are proposed are generally characterized by severe supply and demand imbalances for both rental and home sales. As a result, these areas usually have very low absorption rates of the existing housing supply.

Renting VA properties in a depressed market would have the effect of driving down rents. This downward pressure could result in more foreclosures as rental incomes decline. Correspondingly, the market value of the homes for sale would decline due to the lower costs of rental compared to buying. This could further slow the absorption rate of the excess homes for sale and delay VA's ability to dispose of their inventory.

The National Association of Realtors believes that the most effective approach for handling foreclosed properties in economically distressed areas is aggressive, orderly, and carefully planned disposition programs. Members of the National Association of Realtors are investigating every possible avenue to assist the VA in its property disposition efforts. We believe that if this or any other program to increase sales of VA inventory homes is to work, VA must provide the human resources to meet its goals.

The subcommittee has asked for comments on mortgage insurance versus the current 1 percent funding fee. We are concerned that the current solvency problems of the Loan Guaranty Revolving Fund may be used to change the original entitlement purpose of the Home Loan Guaranty Program. We strongly believe that any insurance program for veterans must be funded in such a way that it does not raise the cost to the veteran beyond the current 1 percent funding fee. Our association would have serious concerns if a VA insurance program were not provided sufficient reserves to cover its contingent liability. As the MMIF of the FHA 203 program suggests, the cost of an insurance program to the veteran could be substantially higher than the current 1 percent funding fee.

Given the entitlement nature of the VA program, our association cannot support any shift to an insurance program that is funded by veterans. The National Association believes, since the direct loan program no longer has the resources to support the Loan Guaranty Revolving Fund, and given the entitlement purpose of the VA

Home Loan Guaranty Program, Congress has two choices: It can recognize the need for continuing appropriations for the program, or it can re-examine the direct loan revolving fund as a potential revenue source which would reduce the need for general revenues to support the program.

In conclusion I would like to say that the Real Estate Finance Committee of the National Association will be appointing, within the next few days, a task force, and this task force will be charged with making specific recommendations on the timely sale of VA inventory properties in economically distressed areas and long-term solutions to the funding of the Loan Guaranty Revolving Fund. We would be happy to report the results at your June committee hearings.

Thank you, Madam Chairwoman.

[The prepared statement of Mr. Muffley appears on p. 83.]

Miss KAPTUR. Thank you, Mr. Muffley. We would really look forward to that, and we want to thank you for all the work that the realtors have done, especially in working in these areas where we have special problems, as in Texas. I think you are to be commended for that.

Mr. Butera?

STATEMENT OF JAMES J. BUTERA, GROUP VICE PRESIDENT FOR LEGISLATIVE AND REGULATORY AFFAIRS, NATIONAL COUNCIL OF SAVINGS INSTITUTIONS

Mr. BUTERA. Madam Chairwoman, members of the subcommittee, thank you very much for the opportunity to present the views of the National Council of Savings Institutions on the Veterans' Administration Home Loan Guaranty Program.

The National Council, where I serve as director of government affairs, is a trade association representing approximately 550 savings banks and savings and loan associations with total assets in excess of $500 billion. Our members' involvement in the VA program takes three main forms: Direct origination for portfolio holding, operation of mortgage banking affiliates, and participation as both buyers and sellers of Government-backed mortgages in the secondary market.

The VA program has been extremely successful and has facilitated home purchases for over 12 million veterans. I can personally attest to this, since the first house I bought in Washington was financed through the VA, and that was after completing law school on the GI Bill. I have always felt that the main problem with both these programs is that not enough veterans utilize these two avenues of enhancement.

Another problem we face today is the unprecedented losses that are now being encountered by the VA program. As alluded to in your opening statement, we must keep in mind that the features of the VA Loan Guaranty Program which make it most valuable to the veteran also make it the most risky and expensive for the Government and other participants. The task, as we see it, is to balance the needs of the veterans, which are the same as they were 40 years ago—namely, access to affordable housing—with the economic realities of today, which are quite different.

The indisputable fact is that the vast majority of real estate losses today, in both the VA program and the conventional market, stem from the abatement of inflation that drove real estate prices consistently upward in the late 1970's and early 1980's. Deflationary trends appeared throughout the country but were most significant in regions where dominant industries, such as industry and agriculture, suffered most severely.

During the highly inflationary seventies and early eighties, escalating values of the underlying property covered up many of the risks associated with lending to borrowers who placed little or no money down. If borrowers could not meet monthly payments, properties could be sold profitably and loans paid off without the need of going through foreclosure. In deflationary times, however, the reverse dynamics set in. If a borrower cannot make the payments, the ability to sell the property and to recover the losses evaporates.

Disinflation, while good for the economy in general, has caused tremendous upheaval in the real estate finance industry. With persistent inflation, problem loans were propped up so lenders, mortgage insurers and investors approached the market with a "volume equals profits" mentality. The sad fact is that many in the real estate industry, and I include lenders in that category, were slow to realize that the old rules no longer apply, and thus the VA loan program is not the only major mortgage program losing money today. As is well known, the private mortgage industry has also experienced large losses over the past few years.

The relationship between risk and borrower equity in a home has never been more pronounced. The one fact that we would hope to leave with you this morning, above all others is, the less equity, the greater the risk.

A major study which we have included in our testimony, prepared by Moody's Investors Services, draws precisely this conclusion: Loan-to-value has been a particularly sensitive measure of relative risk, since it delineates the degree to which the borrower has a stake in the property, especially in the early years of the loan. Based on data for origination of loans between 1957 and 1983, loans with 5 to 9 percent downpayment were almost twice as risky as loans with 10 to 14 percent downpayment, and more than three times as risky as loans with 15 to 19 percent down—the traditional 80/20 valuation.

The response of the private sector to the rash of current problems has been dramatic and is perhaps instructive for the purpose of today's hearing. A major repricing has occurred that has changed the availability and cost of certain mortgages that flourished in inflationary times. Very high loan-to-value mortgages are often unavailable at any cost today, and other loans now face tougher underwriting standards and higher fees.

The VA can certainly make changes to its program to reduce costs to the Government, but this may remove some of the most valuable features of the program. The most important feature, of course, is the no money down, 100 percent financing, and approximately 66 percent of VA loans are originated in this manner. Either the 1 percent fee must be increased, across the board or for riskier loans, and/or downpayments must be required if the VA program is to be made more actuarially sound. However, since the

VA program has traditionally been, as we have heard from a number of the panelists this morning, an entitlement program for veterans, the Congress may decide that this cost is well worth bearing through a direct Federal appropriation—a path which is admittedly difficult in today's cost-conscious environment.

Before concluding, I would like to address a question you raised in your invitation to testify, and that is the disposition of VA-foreclosed properties in distressed regions. Perhaps I could best do that, in the interest of time, by associating my comments with the remarks made by Mr. Perlman. We are very concerned about the VA selling these properties at auctions and at other prices that are too low in order to get them off the books. The VA may experience a temporary gain through programs of this sort, but existing homeowners and other lenders holding properties through foreclosures are hurt by these activities.

Thank you.

[The prepared statement of Mr. Butera appears on p. 96.]

Miss KAPTUR. Thank you, Mr. Butera, and I want to thank the entire panel.

Mr. O'Toole, you have a long and illustrious career association with the veterans' housing program. If our committee wanted to gain a better understanding of where the $500-plus-million shortfall is in the program today and we wanted to get a time series printout, say over the last 20 years, of how we got to that $526 million deficit, where would one go within the Government of the United States to best obtain that financial statement. It should also reflect what Mr. Butera was talking about, and that is the inflation, the default rate, but also the cumulative impact of asset sales over the last 20 years? Would the best place be the GAO? Should we get the mortgage bankers to do it for fun? Where would we go for this information?

Mr. O'TOOLE. Well, the MBA would be happy to help out in any way we can, but I would think that kind of detailed information about how the money was spent and where it came from, would come from the VA.

Miss KAPTUR. Well, I see the VA is still sitting in the back there. I wondered if they would have that information or not, because I think this committee would certainly appreciate a summary statement, financial statement, of how we got to the point where we are now and what factors are contributing to the shortfall. Mr. Vogel, I see you sitting back there. Is that going to cause you a lot of sleepless nights?

Mr. VOGEL. Madam Chairwoman, how we came up with the $525 million or how, over time, we got to this?

Miss KAPTUR. How, over time, we got to this. This just didn't start yesterday. It really didn't start with the auctions in Houston. This started a long time ago. I am sure there are several contributing factors to the shortfall. I think the committee would appreciate a better understanding of how much of it was due to the financial crunch of the late 1970's, how much of it was due to asset sales over time, the cumulative impact of that, how much of it is due to actual defaults. My own impression is that, in spite of the fact that there are no downpayments, I think our record of veterans paying

back their mortgages is pretty darn good, so I guess I am looking for the series of factors that are contributing to that loss.

Mr. VOGEL. We can provide that. Yes, we can provide that.

[See p. 195.]

Miss KAPTUR. All right. We would greatly appreciate that, as one of the questions that we will submit to you as a result of your testimony.

I wanted to also ask Mr. Perlman from the Home Builders, in commenting on mortgage insurance you mention the entitlement nature of the Loan Guaranty Program and object to the insurance approach of requiring a veteran to compensate the Government for assuming risk. Would it change your position if the Government were to bear a portion, perhaps a significant percentage, of the insurance cost?

Mr. PERLMAN. You are talking about financing it into the mortgage, Madam Chairwoman?

Our position is that the VA program is an entitlement program. It is a promise that was made to veterans long ago, and our policy is that that nature of the program should still remain.

Miss KAPTUR. All right.

Mr. Burton?

Mr. BURTON. I am a realtor, as well, before I came to Congress. I am not selling property any more, but I remember the FHA 235 program, where they built these cracker box houses without proper insulation and there was no downpayment for those. As a result, you had an awful lot of people that would buy those houses and in the short run, when they had a cold winter, because of the heat loss people would just walk away from them. We had a terrible, terrible problem with that in many urban areas around the country.

We have never had that problem with the VA Home Loan Program that I have known of in the past. Veterans seem to be very responsible, and when they get a no downpayment or a very low downpayment loan, they seem to stay with the housing, but unfortunately, because of the recession there has been an increase in the foreclosure rate.

I just wonder what is the answer? You say that you don't think that there should be the auction program, that that should be minimized or eliminated. What is the answer to keep veterans in these homes, to reduce the foreclosure rate? To have some kind of a program, maybe, where they acquire part of the downpayment through working on the property? I know it is an entitlement, but what inducement could be provided that would keep more people in these houses and reduce the foreclosure rate? I don't know whether I am making myself clear or not, but maybe you have some idea of what I am talking about.

Mr. PERLMAN. Well, I think that the problem, at least in Houston, has been that the VA action itself has contributed to the problem. It is a self-fulfilling prophecy. If I live in a house that I have a mortgage on, for example, of $80,000, and the VA auctions the house that is next to me for $40,000, I am going to be hard-pressed to continue to make the payment on that $80,000 mortgage, so it is a domino effect as long as the VA continues to sell these houses at——

Mr. BURTON. If I might interrupt, but if that house goes on the market and a realtor lists it and he is going to sell it, the supply and demand will dictate that the price of the house probably will be lower. Whether it is auctioned off or sold through the realtor, won't the price still be lower than the house next door?

Mr. PERLMAN. I think the market place is artificially priced low, as we have had a significant number of investors coming in and buying these properties from auction at bargain prices. They will attempt to skim, if you will, or to rent the properties, and the VA might end up with a foreclosure on the second go-round. So it has been a domino effect in Houston.

Mr. BURTON. Well, I think the chairwoman is probably more up-to-date on this because I wasn't at the Houston meeting, but what I would like to get from you gentlemen, in writing, if possible, are your recommendations on how to deal with this Gordian knot, because that is what it appears to me to be. You have an entitlement program where there are increasing foreclosures and, as a result, the Loan Guaranty Program is in difficulty. To continue down that path that we are on might cause further problems, as the mortgage banker was talking about, and I would just like to know if collectively you have some kind of a solution in mind that you could give to us in writing. I know time constraints prohibit us from getting into details today.

[Letter from Mr. Perlman to Congressman Burton appears on p. 75.]

Mr. BURTON. Yes, sir?

Mr. MUFFLEY. Congressman, I would just like to make one comment. I think the chairwoman touched on it. We did have a severe crisis in the late seventies, but I think what we are forgetting is that many areas of our country are still in a severe crisis. My State in particular has been hard hit, the agricultural, mining, and timber industries, along with the oil industries, so what we are dealing with here in a lot of ways is economic problems, and probably there is no long-term solution to those situations.

Mr. BURTON. The one thing—and I don't want to prolong this—but the one thing that I think that you alluded to was that where you have a larger investment in a downpayment, your foreclosure rate is reduced dramatically. That is probably caused by a myriad of reasons. The fact is, if people have a larger investment in it, they are less likely to walk away from it.

Of course, this is an entitlement program, so we don't want to jeopardize our veterans who are trying to get home ownership, but I was wondering if there is some kind of middle ground there where you can keep this thing as an entitlement and still limit, at least minimize, the walking away and thus the foreclosure of the property. I mean, if there is no downpayment it is easier to walk away than if you have 20 percent down. I mean, we all know that, because of the pain of the pocketbook, so I would just like to know if you have some recommendations, and there may not be any but I would like to know what you have, in writing.

Mr. MUFFLEY. This is one of the things that our task force will be taking up, to report back to you in June, but I also want to mention—and something that hasn't been brought up here—in those economically distressed areas we have seen as much as a 30 to 40

percent decline in property values, so if you have a veteran out there with a $60,000 mortgage on a home that is suddenly, overnight worth $38,000 to $40,000, you are going to have a severe problem. I am not sure that a 20 percent downpayment is the answer, either, because these people are feeling the same crunch, so it is a tough one.

Miss KAPTUR. Mr. Muffley, I am hoping that the analysis the VA will do for us will give us some sense of how much of that shortfall is attributable to regional economic difficulties. I would expect that would be one of the factors that is contributing, and we would like to know to what extent. I think that will make a difference in the action we take at the policy level here for the long-term future of this program.

All of you gentlemen will receive letters from us with additional questions. Mr. O'Toole, we will be asking you, based on your long history with this program and your knowledge of it, for any specific recommendations you have for the long-term survival of this program. We would certainly encourage you to be very creative in your replies there, and we thank you very much.

Our next panel will be Mr. Jerry Connors, president of the Manufactured Housing Institute; Mr. Martin Heck from the National Manufactured Housing Finance Association, accompanied by Mr. James Brodsky; Mr. Bill Hylton, chairman, Public Affairs Committee, Society of Real Estate Appraisers, and finally Mr. Robert Edelstein, professor of business administration, who has flown in especially for this hearing from the University of California, Berkeley, who chairs the Real Estate Faculty Group.

We would ask Mr. Edelstein for any comments he may have, during his period of testimony, on any of the witnesses who have come before, for any specific comments you might have relating to some of the statements that have been made here this morning.

I would also ask, if we run overtime and get a vote here, if the veterans' panel which is to follow, if it would be acceptable to them, since they are based here in Washington, to submit their testimony for the record and perhaps come back at a later time or for a private meeting with myself and with the ranking minority member, Mr. Burton, in order that we can finish on time. If that is objectionable, we will try to accommodate you, but we thought you could caucus while we are hearing this panel.

Mr. Connors?

STATEMENT OF JERRY C. CONNORS, PRESIDENT, MANUFACTURED HOUSING INSTITUTE, ACCOMPANIED BY JOSEPH OWENS, VICE PRESIDENT FOR FINANCE

Mr. CONNORS. Thank you, Madam Chairwoman. My name is Jerry Connors. I am president of the Manufactured Housing Institute. With me this morning is Joseph Owens, our vice president for finance.

The Manufactured Housing Institute is a national trade association representing manufactured home builders and related suppliers of goods and services to the industry and its consumers. MHI manufacturer members produce over 60 percent of manufactured homes built in the United States.

The advantages of mass production spawned the development of factory-built housing over 50 years ago. Today there are several forms of factory-built homes, including modular, panelized, and manufactured homes. Our remarks concern themselves with the form of factory-built housing known as manufactured homes, formerly known as mobile homes.

The Veterans' Administration was first authorized to guarantee loans on manufactured homes by the Veterans' Housing Act of 1970. The 1970 act provided for termination of the program on July 1, 1975, to give Congress time to evaluate this new program. The program became permanent with the passage of the Veterans' Housing Act of 1974, and Congress affirmed its belief that the VA Manufactured Home Loan Guaranty Program was beneficial and provided a good source of housing to veterans.

The program has provided an estimated 110,000 veterans the opportunity to own their own home since its inception through the end of fiscal year 1987. For this reason, we believe that the program is an important and valuable part of the overall benefits provided to veterans through the various activities carried out by the VA.

The subcommittee has indicated its wish to explore the benefits of mortgage insurance versus the 1 percent VA funding fee. We cannot comment on which method would provide the most advantageous funding method for the VA Home Loan Guaranty Program. We would, however, like to make some comments regarding mortgage insurance, based on our experience with the HUD/FHA Title 1 Manufactured Home Loan Insurance Program.

That program is designed to work as an insurance program on a portfolio of loans, rather than as insurance on a loan-by-loan basis. This kind of program design leads to situations where a lender may find itself unable to have an insurance claim paid because insurance coverage, calculated in the form of reserves, has declined to zero. This situation would not happen if insurance were applied to each loan and stayed with each loan for the life of the loan. Loan-by-loan insurance, such as private mortgage insurance, is the typical coverage provided by private insurance.

We would urge the subcommittee to avoid the FHA Title 1 manufactured home loan insurance approach of establishing portfolio reserves as the criteria for claim payments, should they decide to pursue an insurance program for VA loans. We would hasten to add here that, while we have great concerns about the reserve calculations of the FHA Title 1 program, we think that there is substantial merit in eliminating some of the administrative and paperwork differences in the VA Manufactured Home Loan Guaranty Program.

It has been claimed that losses on VA guaranteed manufactured home loans exceed those for site-built homes. We would respectfully submit to you that this is not the case. Claims paid on VA guaranteed site-built home loans far exceed those paid on manufactured home loans in the aggregate because, in fact, there are far more VA guaranteed loans made on site-built homes than on manufactured homes.

Of greater interest, however, is a comparison of VA guaranteed loans on site-built and manufactured homes with similar price

ranges and downpayments. Taking the property management fee into account, the average cost of a site-built claim rose from $10,465 in fiscal year 1979 to $13,245 in fiscal year 1983. For manufactured homes where there is no corresponding property management fee, the average claim for foreclosure rose from $10,217 in fiscal year 1979 to $11,562 in fiscal year 1983, an increase of 13.2 percent. In fact, when one compares claim rates for similarly priced homes with loans guaranteed by the VA with downpayments of less than $1,000, the finding is that claim rates on manufactured homes are not much higher than those on site-built homes.

We believe that the VA Home Loan Guaranty Program has provided a valuable benefit to veterans by allowing them to experience the pride and satisfaction of home ownership. As the subcommittee examines alternative solutions to the solvency of the VA Manufactured Home Loan Guaranty Program, we would urge that it examine those solutions in light of their effect on the eligibility of VA guaranteed manufactured home loans for the Government National Mortgage Association secondary market program for manufactured home loan pools.

Unlike site-built home loans, the Manufactured Housing industry's only access to an organized secondary market program for home loans is through the Ginnie Mae program for VA guaranteed and FHA insured loans. Since most VA guaranteed loans are pooled into the Ginnie Mae program, the loss of this program would likely cause lenders to cease making VA guaranteed manufactured home loans. This would deny many veterans the only source of low-cost housing available to them at their income levels.

Thank you, Madam Chairwoman.

[The prepared statement of Mr. Connors appears on p. 108.]

Miss KAPTUR. Thank you very much, Mr. Connors.

Mr. Heck?

STATEMENT OF MARTIN HECK, PRESIDENT AND CHAIRMAN, NATIONAL MANUFACTURED HOUSING FINANCE ASSOCIATION

Mr. HECK. Madam Chairwoman and members of the subcommittee, my name is Martin Heck. I am president of Home Owners Funding Corporation of America and president of the National Manufactured Housing Finance Association. My testimony focuses on improvements to the VA's Manufactured Housing Loan Guaranty Program that would reduce the VA's high default rate and losses from the Loan Guaranty Revolving Fund.

The NMHFA is comprised of lenders and others interested in the financing of the retail purchase of Manufactured Housing, both conventionally and through the use of the programs of the Veterans' Administration and the Federal Housing Administration. The Association commends the subcommittee's dedication to the VA's housing program and to examining suggestions for creating long-term solutions to the Loan Guaranty Revolving Fund's solvency, rather than looking for quick fixes that ignore the underlying causes.

The Manufactured Housing finance community shares the VA's and the subcommittee's deep concern with the losses experienced

under the Manufactured Home Loan Guaranty Program. With every VA claim, the lender invariably experiences a financial loss, and a veteran borrower suffers the loss of his or her home. We want to see the VA Manufactured Home Loan Program strengthened rather than abandoned, whether by the administration or by the lender community.

As an overview of the housing programs under the VA, I would like to offer the following observations: The VA housing programs were created and are intended to benefit the men and women who served our country in the Armed Forces. It is an entitlement program that should not be eliminated or whittled away. In today's housing market, the housing programs uniquely available to the veteran become an affordable and irreplaceable source of housing. Accordingly, the VA Home Loan Guaranty Program should not be altered in any manner whereby the veteran would be denied his or her rightful entitlement.

Although the VA Manufactured Home Loan Program is a small part of the VA housing program, it complements the veteran community's housing needs by affording low- and moderate-income veterans and active duty personnel and their families the opportunity to own their homes. Although the default rate of the VA Manufactured Home Loan Program may be higher than the default rate for the VA Home Loan Guaranty Program in general, the manufactured home loan default rate does not differ significantly from the default rate for VA loans on site-built homes in the comparable $25,000 to $35,000 price range. We therefore believe that the higher default rate with VA manufactured home loans is not an outgrowth of Manufactured Housing per se, but rather is a byproduct of the financial security of the borrower.

My written testimony commented on a number of changes to the Manufactured Home Loan Program that, if made, we believe would lead to a lower default rate. Allow me to highlight the following points:

A surprisingly large portion of VA's manufactured home loans are made to active duty personnel, with guarantees available for personnel with as little as 180 days of service. In fiscal year 1987, over 51 percent of VA-guaranteed manufactured home loans were made to active duty personnel. Since the inception of the program, the six States of North Carolina, South Carolina, Georgia, Florida, Texas, and Oklahoma—States with a high concentration of military bases—have accounted for 57 percent of all VA manufactured home loans made nationwide, and 63 percent of all claim payments.

We believe that a significant number of claims occur when active duty personnel are transferred from one base to another. As we understand it, the Department of Defense does not move the homes of service personnel below certain grades. Transferees in the lower ranks have little choice but to abandon their homes. Claims also arise when active duty personnel are discharged or retire from the service.

Much can be done to improve the performance of loans made to active duty personnel. The VA and DoD should be urged to help the serviceman who is transferred in selling a manufactured home or finding an assumptor for the loan. A housing referral service

which links military personnel seeking housing and those trying to locate a buyer or assumptor should be set up through each base housing office. For manufactured homes placed in a park within a military base, lenders should be given ample time to sell the home on site or to find an assumptor for the loan. Military members should be given significant information about their VA obligations and the consequences of default and repossession.

These and other changes should be implemented by the VA and the DoD to help secure an assumption of servicemen's manufactured home loans. Otherwise, a new loan is financed, a relatively new one is abandoned, and a claim is filed with the VA.

Although we understand from the VA that it has been actively pursuing collections from defaulted obligors, we believe more can be done. Particularly, the VA together with DoD should be more aggressive in pursuing collections from active duty personnel or discharged servicemen who have defaulted on their VA guaranteed loans. To the extent that the collections are shortchanged and are not paid back into the Loan Guaranty Revolving Fund, other veterans or active duty servicemen seeking to obtain a new VA-guaranteed loan are penalized by prolonging the continuation of the 1 percent funding fee.

The VA has demonstrated a willingness to work with the industry to provide creative solutions to reducing the default rate and allowing the veteran borrower to keep his or her home. The VA should be encouraged to continue to work with the lending community and to strengthen the VA housing program.

The National Manufactured Housing Finance Association appreciates the opportunity to express its views to the subcommittee and welcomes any questions that the members or the staff may have.

[The prepared statement of Mr. Heck appears on p. 115.]

Miss KAPTUR. Thank you, Mr. Heck, very much.

We will move along quickly to Mr. Hylton.

STATEMENT OF BILL T. HYLTON, CHAIRMAN, PUBLIC AFFAIRS COMMITTEE, SOCIETY OF REAL ESTATE APPRAISERS

Mr. HYLTON. Good morning, Madam Chairwoman and members of the subcommittee.

Miss KAPTUR. Good morning.

Mr. HYLTON. My name is Bill Hylton. I am chairman of the Public Affairs Committee of the Society of Real Estate Appraisers. I am a veteran. I am a realtor. And wearing so many hats has taken its toll, as you can see.

[Laughter.]

This morning I would like to talk to you a little bit about the Society of Real Estate Appraisers. The purpose of our society is to elevate the standards in real estate appraising and analysis, to aid in the solution of problems that the profession faces in appraising and analyzing real estate, and to designate certain of our members as having attained demonstrable skills and knowledge. Our members are pledged to maintain a very high level of trust and integrity in their practice. It is our responsibility to keep our members up-to-date with all techniques, tools, and market practices, to know

and to utilize data sources, and to be aware of the influences in which our clients' decisions must be made.

The VA program has established a place in the market. It takes a leading role in the national economy as far as housing is concerned. It sets the standard in many, many cases, and it has a responsibility to maintain this role. I have lived with the VA since its inception right after World War II.

Miss KAPTUR. So we have a real expert here, right?

Mr. HYLTON. Right. I have benefitted from the Veterans' Administration through buying my own home. I have benefitted as a realtor by being able to utilize the VA services and Loan Guaranty Program. As a builder I have also been able to use the VA for inspections. Now as an appraiser, they pay my livelihood, and a lot of others like myself across the Nation.

This is a position in the market that must be maintained. We are facing right now a situation that is not necessarily the VA's fault. The economy in some of the States has deteriorated to a point that all markets are losing. The mortgage lenders themselves are suffering. The entitlement program that we now have cannot survive without appropriations from Congress.

And with this statement, as the VA goes, so goes the Nation, in the way of mortgage lending, and mortgage fees. They set the trend. Right now they are at 9.5 percent. Most lenders now are matching that or sometimes coming a little under it. If they go to 10.5, the rest of the market is going to go the same way. If they cut to 9, it is going to be the same thing. It is very important that the VA be viable.

The additional funding that is requested by the Veterans' Administration to cover these losses by the Home Loan Guaranty Program makes it clear that the viability is threatened. This subcommittee has held oversight hearings on this subject in the last session. This included a look at the appraisal process.

In other congressional investigations it has been reported that the Inspector General for the VA has found deficiencies in these appraisals. We cannot deny that. They have taken place. Sound, independent appraisals are essential in our business today. We stand committed to trying to ensure that you get those sound appraisals.

We have recently organized the Appraisal Foundation, which now the eight leading appraisal organizations as members. We have recently adopted uniform standards of professional practice, which appraisers now all adhere to. It is absolutely necessary, that we provide you with competent service. The integrity of your program relies upon supported appraisals.

To the extent that the society can be of assistance to you to maintain this goal, we look forward to working with you. Mr. Don Kelly is with me. He is from our Washington office. We stand ready to assist you at any time with any problems you might have.

Thank you for the opportunity to be here.

[The prepared statement of Mr. Hylton appears on p. 123.]

Miss KAPTUR. Thank you, Mr. Hylton, very much. Those are extremely interesting comments, and I want to commend your society for all the work you have done in order to provide a very high level of service around the country, and also standard operating proce-

dures for appraisals within the Federal Government as a whole. I know you have been real involved in that.

Mr. Edelstein, we thank you for being with us this morning. You have come a long way. We did not get formal testimony from you but we really have you here as an expert witness, and if you have comments based on anything you have heard or your own original research, we would welcome it now.

STATEMENT OF ROBERT EDELSTEIN, PROFESSOR OF BUSINESS ADMINISTRATION, UNIVERSITY OF CALIFORNIA, BERKELEY

Mr. EDELSTEIN. Thank you very much, Madam Chairwoman and members of the subcommittee, for having me here today. I have benefitted by hearing the testimony of the earlier witnesses, and I would like to make some summary comments.

First of all, there are several and complex things happening simultaneously. There is a concern about short-run problems of the VA guaranty fund as well as its long-run viability. In my opinion, you should try to decide what is needed to be done to insure the long-run viability of the program; and how do you intend to sustain it. Then the short-run problem becomes a part of the problem of deciding how you go from where you are now to where you want to be, and what is the transition going to look like. Funding the program to make it go another 6 months or another year is not the answer; because whatever created the problems we now see will not go away, and will in fact continue to exacerbate the problem.

Second, there is a basic conflict between entitlement versus making the program a pay-as-you-go, viable business venture. On the one hand, we heard witnesses refer to balancing the needs of veterans, i.e. the entitlement notion, and on the other hand, if veterans were to receive a better deal, that by its very nature must increase the risk for those who are the guarantors of such programs. The guarantee funds are at risk.

The loan-to-value ratio—I think Mr. Butera talked about that—is the key variable for predicting default risk, and that is true; but he also observed that 66 percent of the participants in the Guaranty Program enter the program with zero down payment. In other words, that is considered the attractive entitlement element, and well it should be.

Now the question is, how do you make the program work? There are a couple of things that I would like to summarize in reiteration of what was said. First of all, the VA experience, though unique in itself in many ways, reflects market phenomena, and that fact must not be lost in the analysis. The initial statements by Mr. Vogel talking about the level of financing and refinancing activity recently; This is exactly what has happened in the private sector—no surprises. It has been a period of falling interest rates, and that has made large scale refinancing attractive to homeowners.

The cyclical economy and the regional cyclical economies have caused a great deal of foreclosures and property problems in the private sector. You are experiencing the same phenomena in the VA programs. Whenever the VA has guaranteed loans where the economies are weak, it has experienced increased real estate loan problems.

If we take a longer view, and we don't think that oil will always be about $15 a barrel, it has been $42 a barrel within recent memory, and it has also been $10 a barrel even more recently. In the long run energy is a valuable commodity, the economics of these geographic areas are eventually going to improve, and the loans under the VA programs in such areas will actually work again.

One fact that appears to have been lost is that since the Second World War, we have basically been in a growth era, and real estate values have done very well. In the early eighties there were some major changes. Disinflation for complex reasons caused several regional real estates market to falter, thereby exposing real estate loans to new, unanticipated dangers of default.

In this context, let me talk about how you develop a proposal which addresses long-run viability for the VA guaranteed loan programs. The underlying assumption is that this is a volatile economy, much more volatile than it has been historically, and is likely to be that way. Other than 1929, there haven't been many October 19ths. I think that is indicative of what we see in the economy, not only in real estate but in other real and financial sectors. Given that, let me talk about a proposal that encompasses some of the things that have been said about the long-run viability of the fund and the pricing of the VA guarantees.

One proposal or set of proposals talks about increasing loan points up front, that is, fees which may be added onto the loan, but basically the government would receive fee income when loans are originated. The disadvantage of this type of proposal is that it would increase monthly payments, if the points are added to the loan, or it would increase downpayments. In either case, it would be attacking the entitlement directly.

Another proposal which has been mentioned, but not this morning, is that we should go the route of mortgage insurance or even private mortgage insurance. Let me suggest to you that the private mortgage insurers have lots of problems of their own, reflecting exactly what the VA has been experiencing. Basically, if you made loans in the Southwest and you guaranteed them, and the market values declined, it would seem logical that you just can't make the program fiscally viable. When values fall in half and you are the guarantor for the top 30 or 40 percent of a loan, you are in trouble, no question about it. Moreover, this would happen not to one loan; it would happen systematically to all loans in an area. Hence, I conclude that "privatization" is a glib non-solution.

Let me propose an alternative which maintains the initial entitlement; but on the other hand, doesn't penalize the losers, that is, those who default, who are already losing their homes. Instead my proposal would take some benefits, but I think what I would consider fair, from the winners, whose property values have increased.

If you bought a house in New England, where the economy was strong and house values were appreciating very rapidly, the VA guarantee program has experienced much lower foreclosure rates than in other economically weaker geographic areas. This reflects the underlying real estate markets, but under the current VA program the "winners" do not compensate the "losers," or in this case the real loser is the Government. I suggest that we think about

what I will call a shared appreciation program, which retroactively charges fees to participants in the program whose property values have increased.

Let me give you a hypothetical numerical example. Let's say I bought a house for $100,000, nothing down, with a VA loan guarantee. The house cost $100,000, fees and everything. A few years later I sell it for $150,000 net. Basically, with no initial equity, I have created $50,000 in equity by participating in the guarantee loan program. Should some of that $50,000 be returned back to the program that created the benefit, let's say 5 percent, retroactively? In this example, upon the sale, the VA would receive 5 percent of $50,000, or $2,500.

Now this will not solve your problem short-run but it will tend to, if priced correctly, solve your problem longer-run, where losers walk away and the Government sits there with the property and the loan. Winners, when they sell, transfer, or refinance their property and money is coming out of the property, will give a portion of their gains back to the Government to fund the program. We generate fees retroactively, so people pay when they have actual gains under the program, not in the beginning. The proposal doesn't hurt anybody's pocketbook up front. The difficulty is, it only will work as a viable option somewhere down the road after people develop some appreciation, so it is a long-run solution which doesn't solve the short-run funding problems you have now.

Another issue raised today relates to the Government's strategy for disposing of properties it owns because of loan default and foreclosures. Simply put, When people in the stock market tried to dump stocks on October 19, 1987, what happened to stock prices? They fell further. The same thing can happen in a localized real estate market. I think that the Government should consider, in depressed markets, rental strategies, strategies where they do sell properties with participations. In places like Houston, if you believe oil prices will raise again, in the long run real estate values will come back. In such a market, it might be wise to hold real estate for awhile until the market comes back, or sell with participation in the future appreciation.

Hence, there are creative ways of approaching disposition that will reduce the burden on the marketplace, without overloading supply, and simultaneously will increase the financial take that the Government will have. Thank you.

[The prepared statement of Mr. Edelstein appears on p. 218.]

Miss KAPTUR. Well, Mr. Edelstein, I want to thank you very much. People come in and always defend the past to us. We rarely get testimony that helps us look down the road. That has been my experience after only 2 years on this committee—as Chair of this committee,—so we appreciate the thoughtful presentation that you have made, as well as the other witnesses.

I wanted to ask Mr. Burton, I think you had a question or two, did you not?

Mr. BURTON. I just had one quick comment.

Your innovative suggestion for taking part of the profit from one area and using it to offset the other, picked my brain a little bit. I was in real estate and insurance before I came here, and the insurance companies have a reserve fund that they have set up in many

States which provides—in the case of insolvency on one company, and there are policyholders involved who are losing money because of claims that are incurred—this reserve fund is used to pay those claims. I just wonder if maybe instead of the proposal that you have made, maybe the lending institutions could provide a reserve fund not unlike what the companies do in the insurance field to pick up that slack, rather than start shifting profits around. It is just another possible suggestion, and since you are an expert——

Mr. EDELSTEIN. Where would those funds come from?

Mr. BURTON. What?

Mr. EDELSTEIN. Where would those funds come from? They would have to be taken out of, let's say, mortgage payments and put aside as reserve.

Mr. BURTON. That's right.

Mr. EDELSTEIN. The difficulty with that, that would tend to raise the interest rate that borrowers would be required to pay. Okay? I am saying here is a plan which retroactively sees who the winners are and charges them; they have really been the beneficiaries of the program.

Mr. BURTON. The only problem with that is, you are going to find regional resistance, and when Congressmen—being realistic—when Congressmen from one part of the country where they are doing very well economically start talking about taking from their people to help people in the other part of the country, you run into a real log jam down on that floor. Although the idea has a lot of merit, I was thinking that you might think of this other idea and maybe expand on it, because obviously you are a learned man who works with these ideas all the time.

Mr. EDELSTEIN. Thank you, but let me suggest that it is hard to tell who the winners are going to be. Ten years ago if I were sitting in this room we would talk about the problems in New England and the economy there, 15 years ago for sure, and we would talk about booming Houston. Things change, and the whole notion of the insurance program is that the distributions, you can go back and see what the distributions have been and see that over long periods of time they will even out.

Mr. BURTON. Well, Madam Chairwoman, I would just say that if this idea is pursued, and I think it does have some merit, we probably need some historical perspectives like that which you have just alluded to, so that when we go to the floor we can point out to those Congressmen who may be recalcitrant and say, "Hey, you know, you guys were hit not so long ago," so we need to have some kind of historical perspective.

Thank you.

Miss KAPTUR. Thank you, and I will just mention, as I had last year when we had our first set of comprehensive hearings on this program, when I first became Chair of this committee I searched for dissertations or studies that had been done on the veterans' housing program over the last 40 years. We searched the entire Nation. There has never been one Ph.D. dissertation written on this program, nor any exhaustive analysis of how it has functioned and ways that it can be changed for the benefit of its users down the road. That was one of the most shocking things I have ever learned as a member of the Veterans' Affairs Committee.

And so it has been very hard to get expert witnesses to testify because, frankly, there aren't any who aren't in the business. I am not saying that all of you who represent associations aren't important, but everybody tends to get trapped by what they are doing today, and it has been so hard to get policy-level suggestions from witnesses. We really do appreciate the special efforts that you have made this morning, and we hope that we can develop some type of working relationship with your center for the benefit of this program.

I know that many of the other witnesses—Mr. Hylton, for example, the real estate appraisers—there are a lot of people who really know the nuts and bolts of this program and how it has worked, and why it is important to the country. I agree with you, we are the pacesetter—a lot of people don't understand that—and very important in the marketplace, and that is why we have to ensure the sound operation and survival of this program as a market leader.

We appreciate your testimony this morning. We will be submitting written questions to all of you gentlemen. Mr. Edelstein, if you have a few extra minutes, you may wish to spend some time with our professional staff prior to departing again for California. They are up here today. We want to thank all of you very much for coming.

Now I know there are veterans' groups in the audience, and I would certainly call you to the table officially to submit your testimony for the record: Mr. Dennis Rhoades from the American Legion; Mr. Stephen Edmiston from the Disabled American Veterans; Mr. Dennis Cullinan from Veterans of Foreign Wars; Mr. Richard Johnson, Jr., Non Commissioned Officers Association; Mr. John Bollinger, Paralyzed Veterans of America; and Mr. Paul Egan, Vietnam Veterans of America. Mr. Rhoades was to be accompanied by Mr. E. Philip Riggin from the American Legion, as well.

We are facing this briefing on Honduras, and in view of the importance of it I am wondering if we could just officially accept your testimony this morning for the record, and then if you wanted to come back, we could reschedule a time perhaps or meet with you privately, we are certainly willing to do that. Would that be acceptable to you?

Mr. JOHNSON. Yes, Madam Chairwoman.

Miss KAPTUR. And we would certainly put you first on the agenda at our next set of hearings. We do have your testimony and we know how supportive you have been. One of the things you know we would be interested in is, based on the testimony we have gotten this morning, if you have comments that weren't in your original testimony, if you wish to submit those to us we would certainly appreciate that.

Does anyone have a statement they would like to make, very briefly? No? Not at all?

Mr. JOHNSON. No, Madam Chairwoman. We understand the time constraints.

Miss KAPTUR. All right. We really very much appreciate it. You're wonderful. Thank you.

Mr. JOHNSON. Thank you.

[Whereupon, at 11:35 a.m., the hearing was adjourned.]

APPENDIX

STATEMENT OF R. J. VOGEL
CHIEF BENEFITS DIRECTOR
VETERANS ADMINISTRATION
BEFORE THE
SUBCOMMITTEE ON HOUSING
AND MEMORIAL AFFAIRS
COMMITTEE ON VETERANS' AFFAIRS
HOUSE OF REPRESENTATIVES
MARCH 17, 1988

Madam Chairwoman and Members of the Subcommittee:

It is a pleasure to appear before you this morning to discuss the operation of the Veterans Administration's housing program.

I would like to bring you up-to-date on the current activity of the Loan Guaranty Program. A period of economic stability has permitted VA to keep the interest rate on guaranteed home loans at fairly stable rates. The current rate of 9 1/2 percent has been in effect since February 1, 1988.

During Calendar Year 1987, the VA guaranteed 455,616 loans, which is the highest since 1956. Refinancing loans contributed greatly to this record volume. Due to the lower interest rates of the past two years, refinancing loans comprised approximately 39 percent of the total loan volume in both 1986 and 1987. In 1985 they represented only 10 percent of the originations.

Over 75 percent of acquisition loans in 1987 were made without a down payment. These no-down payment loans had an average purchase price and loan amount of $69,409. For those veterans who obtained loans with a down payment, the purchase price averaged $97,378, with an average loan amount of $86,272. Veterans obtained 4,491 manufactured home loans in Calendar Year 1987. The average purchase price for a manufactured home was $23,510, with an average loan amount of $23,142.

Since the Loan Guaranty program was enacted in 1944, it has assisted more than 12.4 million veterans to obtain housing. Mortgage credit totaling over $306 billion has been allocated to veterans; much of these funds may not have been made available without the benefit of this GI bill program. Over $125 billion worth of these loans have been repaid in full as of last year.

Madam Chairwoman, we are continuing to experience a large number of GI loan defaults. During Calendar Year 1987, defaults averaged 15,158 per month, compared with 15,066 in Calendar Year 1986.

As a result of the continued high level of defaults, there were 140,558 loans reported as being delinquent as of December 31, 1987, an increase of 5.4 percent over the 133,333 pending as of December 31, 1986. This, in turn, resulted in an increased

number of foreclosures and claims. We paid 34,750 claims in Calendar Year 1986. This increased 25.8 percent, to 43,725 claims paid in Calendar Year 1987.

One provision of the Deficit Reduction Act of 1984 was the requirement that at least 25 percent of our properties be sold for cash during Fiscal Years 1985, 1986 and 1987. During these respective fiscal years, 27.53, 33.78, and 33.86 percent of our total property sales were for cash. Public Law 100-198, the Veterans' Home Loan Program Improvements and Property Rehabilitation Act of 1987, increased the minimum requirement to 35 percent for Fiscal Years '88, '89 and '90. The percentage of properties sold for cash during FY '88 (through February 22) was 38.24 percent of all properties sold.

After a significant inventory reduction in FY '85, the nationwide property inventory experienced a net increase of nearly 2,000 properties in FY '86 and another 2,000 properties in FY '87. Sales remained at nearly the same high level in FY '86 (only 2 percent below the FY '85 mark). Property sales increased during FY '87, (a total 34,181 sales) and set an all-time record for sales during any fiscal year. The FY '87 sales record exceeded the previous sales record set in FY '65, by 22.5 percent. These sales were offset by an increase in property acquisitions during FY '86 of 17.7 percent, as compared to the number of properties acquired during FY '85, and a similar increase during FY '87. Fiscal Year 1987 acquisitions were 21.5 percent above FY '86.

The lack of an overall, substantial reduction in inventory during Fiscal Years 1986 and 1987 might give the impression that our nationwide sales effort has been slow. In fact, the record sales show we have been working vigorously at reducing our property inventory. In large part our property sales problems are still located in the "energy belt." For example, if 3 regional offices (Denver, Muskogee and Houston) had just been able to "stay even" by selling the same number of properties that were acquired during Fiscal Years 1986 and 1987, the sales results at the remaining 46 regional offices would have given VA a net inventory reduction of 5,273 properties. Of the 66,394 properties acquired during Fiscal Years 1986 and 1987, 25.1 percent were acquired by these 3 regional offices, with 15.7 percent of the total being acquired by the Houston office alone. These 3 stations now account for over one-third of VA's on-hand inventory.

These are hard-hit real estate markets, with record levels of foreclosures and properties available for sale in all sectors of the market. Many potential buyers are reluctant to buy properties, particularly if substantial cash outlays are required, for fear that real estate values have not yet bottomed out. Under these conditions, we cannot pretend to have found effective marketing strategies which others in similar circumstances have not found. In an effort to overcome these adverse market conditions in the Houston area, our regional office is working closely with an advisory council of

private sector real estate brokers. Substantial price reductions are being made, and more public advertising is being done. More timely service is being provided for purchase offer processing and sales closings.

In Houston the amount of brokers' sales commissions has been increased from 5 to 6 percent. Additional personnel resources and contract money have been made available for property disposition. Auctions are being used to sell older properties. We had begun to see higher monthly property sales and purchase offers in the Houston office and, with the removal of the mandatory down payment requirement, we are hopeful that this trend will continue.

VA continues to acquire properties in these economically depressed areas because the level of loan terminations remains high. Foreclosures at our Houston, Waco, Denver, and Muskogee offices totaled 14,955 during FY '87, compared to 10,990 in FY '86. Among these liquidations there are still numerous instances in which, after considering estimated property acquisition and disposition costs, the net value of the property indicates acquisition is in the best interest of the Government. However, the number of no-bid cases increased significantly from 1,995 (18.2 percent of liquidations) to 4,544 (30.4 percent of liquidations) at these offices from FY '86 to FY '87.

We project a gradual decline in property inventory over the next few fiscal years. Our regional offices have been successful in selling properties (over 60,091 in the last two years) and in reducing the average time properties are held (from 10.6 months in FY '85, to 8.8 months in FY '86, to 8.0 months in FY '87). Based on established trends, holding time for FY '88 is projected to be even further reduced to between 6.1 and 6.9 months. The problem continues to be that the level of new acquisitions has been significantly higher than anticipated, especially in areas most affected by the severe economic downturn in the energy industry.

Our efforts to dispose of inventory properties will continue to be based on timely pricing revisions, increased public advertising, and more effective cooperation with real estate professional groups in local areas. In addition, we will be using public real estate auctions as a supplemental sales technique, where appropriate, to dispose of those properties in inventory for the longest periods of time. The agency's inventory reduction goals have been included in the performance standards of our regional office directors.

Next, Madam Chairwoman, I would like to discuss our implementation of Public Laws 100-198 and 100-253, the two most recent laws affecting the Loan Guaranty Program. As you well know Madam Chairwoman, these two laws affected a great number of areas in our Program. Instructional material has been sent to

our field station personnel and program participants on the new guaranty provisions, the requirement for a down payment on manufactured home loans, the new refinancing provisions, the revised occupancy requirements for VA-guaranteed home loans, and the new requirements for VA-guaranteed loans that are assumed.

In the area of appraisals, Public Law 100-198 provides for the extension, to certain lenders, of authority to review appraisal reports and determine the reasonable value for properties to be secured by VA loans. These lenders would then go on to close the loans on the automatic basis without VA prior approval. Direct VA involvement would not come into play until the request for guaranty is submitted. The new law further provides that in implementing the program the VA shall assign a sufficient number of personnel to perform appraisal reviews and to monitor the participating appraisers and lenders as to the effectiveness and efficiency of the determination of reasonable value by lenders.

The benefit of this lender appraisal review system will be in the improvement of timeliness which will result in better service to veterans. We are proceeding with the establishment of standards, procedures, and regulations for the lender review system. In order to do this, we have met with representatives of the Department of Housing and Urban Development for information on their similar program. Care must be taken in the implementation of the program since VA's liability under the

guaranty is directly related to the soundness of the appraisal report and the integrity of the appraisal report is critical to the success of the loan guaranty program.

Public Law 100-198 mandates actions to be taken with regard to veterans in default, including providing information and counseling to veterans and the calculation of the indebtedness on loans which are ultimately foreclosed.

When a default is reported to us by a lender, a computer-generated letter is sent to the veteran. This letter provides advice concerning what actions might be taken to reinstate the loan. The letter presently offers advice concerning financial counseling offered by VA, and is being expanded to provide a list (and explanation) of options available for reinstatement of the loan or the avoidance of foreclosure. Also included will be a warning concerning the fact that the veteran may remain liable for the debt if the loan is not satisfied when the property is sold. The veteran is advised to contact the VA before selling for information on obtaining a release of liability.

We are writing regulations to implement the requirements on calculating the indebtedness on foreclosed loans. The proposed changes will affect loans involving VA administrative delays and delays due to bankruptcy or VA requested forbearance. These regulations will be published for public comment in the Federal Register shortly.

The indebtedness on cases involving VA administrative delays will be computed as if there had been no delay. However, the holder will be paid for the period of the delay on its claim under loan guaranty.

When there is excessive delay in foreclosure due to bankruptcy or VA requested forbearance in computing the total indebtedness, all interest in excess of 30 days which accrues during the period of delay will be excluded. This is equivalent to setting a cut off date 30 days after the date the sale would have taken place if there had been no delay.

This procedure will only be applied if the loan would be a "no bid" at the time of the actual liquidation sale and if use of this procedure would make it an "upset price" case. This means that if the holder would have the option to convey to VA, based on the total indebtedness (and net value) as of the actual liquidation sale date, the indebtedness will not be adjusted.

Public Law 100-198 authorizes VA (1) to sell VA acquired properties for use as shelters primarily for homeless veterans and their families; (2) to sell acquired properties to employers who use veterans in a program of job training under the Emergency Veterans Job Training Act of 1983 (VJTA) to rehabilitate properties; (3) to provide priority to veterans in the subsequent purchase of properties rehabilitated under

the program; and (4) to include in a VA provided loan to finance a VA acquired property, an amount to be used for rehabilitation of the property purchased.

To implement the homeless program, we propose to offer discounts up to a maximum of 35 percent off list prices to those eligible to purchase properties under this program. Properties which will be eligible for sale under this program will be those on hand for 12 months or more and are available for an "as is" cash sale. Additionally, there must be no significant likelihood that these properties will be sold at prices sufficient to reduce the liability of the previous veteran owners. VA regional offices will be instructed to identify eligible properties and to prepare listings of them for subsequent distribution to prospective purchasers. Regional offices will also be requested to make contact with any State and local agencies or nonprofit organizations working on behalf of the homeless in an attempt to learn the areas in which the agencies may be seeking properties to be used as shelters and to determine the price ranges of properties in which the agencies might be interested. When a prospective purchaser expresses an interest in purchasing an eligible property, the property will be excluded or removed from the public sales listing and the prospective purchaser will be allowed 30 days in which to provide an offer for the property.

To implement the provisions of the law with respect to using veterans in job training programs under the VJTA to rehabilitate VA acquired properties, we propose to make properties which have been on hand for 12 months or more and are available for "as is" cash sales eligible for this program. Prior to consideration of any offers under the program, VA regional office personnel will verify that the purchaser is a participating employer in an approved veterans' job training program. Discounts offered to approved purchasers will be 25 percent of the minimum acceptable prices for those properties. After completion of a sale under this program, the purchaser will be given two years in which to rehabilitate and resell the property.

Finally, to implement the property rehabilitation loan provision of the law, prospective purchasers will request funds necessary to repair the property at the time an offer to purchase is submitted. Since funds approved under this program are intended to be used to make properties habitable, repairs which will make a property safe, sound, and sanitary will generally be approved. The amount approved for repair of a property may also include repairs which purchasers generally desire to have performed in order to place a property in "move in condition." Rehabilitation funds will be held by a third-party escrow agent and disbursed as the repair work is completed.

As you can see, Madam Chairwoman, we are well on our way to implementing all the provisions of the law. It will, however, be some time before the results will be known. We look forward to reporting to you the effects of the legislation.

In your invitation letter you specifically mentioned several areas that you intend to explore in the future. I would now like to offer brief comments on those items.

We have performed a very general review of mortgage insurance, including our own insured loan program that is no longer utilized by lenders and the program of HUD and private mortgage insurers. We are in the process of making a more detailed analysis of the feasibility of utilizing mortgage insurance in the home loan benefit program by utilizing an outside contractor.

With regard to holding loan assets instead of selling them, we support the Administration's credit reform policy which calls for timely disposal of loan assets without recourse to the Government. It would take a number of years to build up a portfolio of vendee loans with sufficient cash flow to make the revolving fund solvent. During this period substantially greater appropriations would be necessary to support the program.

Your letter also mentions the option of renting certain VA acquired properties until such time as the homes could be sold at a better price. It has been our experience that VA owned properties are more easily sold if they remain unoccupied. This allows completion of repairs and immediate occupancy by a purchaser. Directors of VA regional offices however have been delegated authority to rent properties if rental is determined to be in the VA's best interest. Rental may be warranted if there is little likelihood of an early sale of a property or if properties which are left vacant are subject to excessive risk of damage by vandals or other hazards. Additionally, a property may be rented, for a limited time, to its former owner with an option to purchase as a means of determining his or her willingness and ability to make the projected monthly payments in a timely manner.

Financial considerations regarding the Loan Guaranty Revolving Fund have necessarily influenced decisions with respect to offering properties for rent. While, as mentioned, regional office Directors have the authority to rent properties under certain circumstances, the commitment to meet the needs of the Revolving Fund and to reduce the inventory have tended to limit the exercise of this authority. The Revolving Fund is replenished principally through sales of acquired properties, including income derived from loans which VA made incident to such sales and the proceeds from the sale of the loans themselves to private investors. A rental program would hinder

VA's near-term ability to replenish the Fund, since rentals do not provide the same lump sum of cash that is obtainable from property sales and loan sales. The cash-flow problem created by an extensive rental program would necessitate substantially greater appropriations by the Congress for program operations.

Additionally, any estimates of the time required for the market to recover and the extent to which it will recover would be based on speculation at best. Therefore, it is not possible to determine if such a rental program would be cost-beneficial, since we do not know when or at what prices these properties can eventually be sold.

Madam Chairwoman, this concludes my statement. I would be pleased to answer any questions that you or any member of the Subcommittee may have.

United States General Accounting Office

GAO Testimony

For Release
on Delivery
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VA's Home Loan Guaranty Program

Statement of
John H. Luke, Associate Director
Resources, Community, and Economic
Development Division

Before the
Subcommittee on Housing and
Memorial Affairs
Committee on Veterans' Affairs
House of Representatives

GAO/T-RCED-88-26

GAO Form 160 (12/87)

Madam Chairwoman and Members of the Subcommittee:

Thank you for this opportunity to appear before you to discuss the Veterans Administration's (VA's) Home Loan Guaranty Program. As you are aware, in recent years there has been a large increase in foreclosures nationally--reportedly, a 100 percent increase over the past 7 years. In some parts of the country, the rate has increased several-fold. As a result, both private mortgage insurers and federal mortgage insurers, including VA, began to experience increased claims against their insurance funds. For example, in fiscal year 1987 VA had over 42,000 foreclosures and lost about $465 million on the sale of its foreclosed properties, up from 33,000 foreclosures and losses of $356 million in fiscal year 1986.

Thus, on September 29, 1987, the Chairman of the Veterans Affairs Committee asked GAO to review several aspects of VA's home loan guaranty program, including activities related to loan servicing, property management, and debt collection, as well as the characteristics of the loans contained in VA's portfolio and VA's future plans for selling them. Our work in each of these areas is continuing. As agreed, my remarks today are focused on issues related to VA's servicing of defaulted guaranteed loans. Specifically, they address

- VA's servicing requirements for lenders and how VA monitors lenders' servicing activities;
- how VA's supplemental servicing activities can be improved; and
- the adequacy of VA staffing to provide effective servicing.

In summary, when a VA-guaranteed loan becomes delinquent, VA requires lenders to contact the veteran to determine the reason for

the delinquency and to work with the veteran in solving the problem. VA has a system for monitoring the lender's servicing activities, however, our review to date indicates that VA officials believe that the lender monitoring system could be improved by conducting on-site audits of lender servicing activities. Further, even though VA has recently emphasized to its regional offices the use of foreclosure alternatives--refunding, compromise sales, and deed in lieu of foreclosure--our review shows that VA has not yet extensively used these alternatives. Although foreclosure alternatives have the potential to substantially reduce VA's losses, at the VA offices we contacted, alternatives were used in only about 2.5 percent of the foreclosure cases. VA could better ensure that its foreclosure costs are being held to a minimum by requiring that a least cost analysis of its foreclosure alternatives be prepared and documented for each foreclosure case. Finally, based on interviews with representatives of the VA regional offices, VA's staffing is reportedly inadequate to effectively contact, counsel, and assist the large number of veterans having delinquent loans.

The large increase in claims over the past few years has prompted private mortgage insurers (PMIs)[1] to work more directly with borrowers in developing financial plans to determine the best solutions for curing delinquencies. In addition, lenders told us that the PMIs are more helpful in resolving delinquencies partially because they get involved about 30 days earlier in the foreclosure process than VA. PMI officials told us that their

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[1]To contrast VA's servicing practices with those of the private sector, we visited four PMIs that collectively insure over 70 percent of all conventional mortgages. To evaluate VA's servicing of defaulted loans, we reviewed VA's servicing regulations and procedures, contacted officials at VA headquarters and nine VA regional offices, and visited the top 10 lenders that had the highest number of VA loan foreclosures in fiscal year 1986. We also met with officials at the Office of Management and Budget, the Congressional Budget Office, the National Association of Realtors, and the Mortgage Bankers Association.

companies conduct on-site reviews of the lender's servicing activities, and actively assist the homeowners in selling their homes to prevent foreclosure.

BACKGROUND

Under VA's servicing framework for guaranteed home loans, the lender is required to provide the primary servicing of defaulted loans. VA requires the lender to contact the veteran to determine the reason for the default and to work with the veteran in solving the default. After the veteran misses three monthly installments, however, the lender must report the default to VA. Once notified, VA is required to perform supplemental servicing to protect the interests of the veteran and the government. VA's supplemental servicing activities include reviewing the lender's servicing efforts, contacting the veteran to offer financial counseling and/or financial assistance, and interceding with the lender on behalf of the veteran to obtain forbearance or other financial solutions.

LENDER SERVICING

Under the VA home loan program, for the first 3 months of a delinquency, lenders are responsible for servicing the loan by providing veterans with adequate opportunities to avoid foreclosure. They are to do this by contacting the veteran and providing financial counseling aimed at developing a repayment plan to solve the delinquency before the veteran misses additional mortgage payments and goes deeper in debt. According to loan servicing supervisors at the VA offices we contacted, lenders do not always make personal contact with and provide financial counseling to delinquent homeowners to resolve mortgage delinquencies. Some VA officials told us that they frequently must contact lenders to encourage them to reach agreement with veterans on repayment plans.

VA has a system for monitoring lenders' servicing activities. Basically, the system is designed to measure the completeness and timeliness of the default and intent to foreclose notices provided to VA by the lender and includes a review of the lender's description of the services provided to the veteran. We found that some PMIs will conduct on-site reviews of the lender's servicing files, and some VA officials we contacted said that on-site reviews of lenders could improve VA's current monitoring system. In this regard, the recent VA Task Force on Debt Prevention concluded that VA's monitoring of lenders is not sufficient to ensure that lenders provide veterans with effective servicing. The task force recommended that VA initiate on-site audits to identify lenders that are not meeting their responsibilities for contacting and counseling veterans and working with them in developing repayment plans.

VA SERVICING ACTIVITIES

If a lender's activities are not successful in curing a loan delinquency on a VA-guaranteed loan, VA can use three financial assistance alternatives to prevent a foreclosure. These alternatives are (1) refunding the loan, (2) assisting the veteran to avoid foreclosure by selling the property, and (3) accepting the borrower's voluntary conveyance of the property deed. In testimony before this Subcommittee in May 1987,[2] we pointed out that VA was not taking full advantage of these alternatives. Based on our ongoing work, opportunities still exist for VA to reduce the costs of foreclosure by more aggressively seeking alternatives to foreclosure. Generally, these alternatives will either avoid or decrease the losses experienced on the sale of foreclosed properties. (See exhibit I.) Although foreclosures increased by about 9,000 cases in fiscal year 1987, VA used these alternatives

[2]VA's Home Loan Guaranty Program, GAO/T-RCED-87-24, May 13, 1987.

to foreclosure fewer times than it did during fiscal year 1986. (See exhibits II and III.)

I would now like to discuss briefly the status of each of the foreclosure alternatives, based on our audit work to date.

Refunding

When lenders will not refinance delinquent loans, VA may pay the lender the outstanding loan amount as an option to foreclosure, enabling the veteran to keep the property. VA then "refunds" the loan and establishes a repayment plan based on the veteran's ability to repay the loan. In effect, VA assumes the role of the lender.

As we testified last May, our analysis showed that the cost avoidance from one successful refunded loan would be sufficient to offset the additional foreclosure costs to refund six loans that subsequently fail. (See exhibit IV.) Nonetheless, our audit shows that although VA had more than 75,000 foreclosures during the past two fiscal years, only 473 loans--less than 1 percent--were refunded.

In doing our work, we found that PMIs will refund mortages. They also have other programs to assist homeowners in keeping their property. In this regard, the PMIs will lend money to delinquent borrowers to enable them to reinstate their loans if the PMIs believe that with the financial assistance the borrowers will be able to meet their current and future mortgage obligations.

Assisting veterans to
sell their homes

As an alternative to foreclosure, veterans may sell their homes and pay their outstanding loan balances. However, they

sometimes need financial assistance to do this because the proceeds from the sale are not adequate to pay both the outstanding loan balance and the selling expenses. VA has a program, known as the compromise sales program, under which it may provide the financial assistance necessary to enable the veteran to sell the property. VA provides this assistance when it believes that it is cost effective to do so because the veteran can obtain the fair market value for the property and VA can avoid foreclosure costs.

During the past year, VA has publicized the compromise sales program because of its potential to reduce foreclosure costs, which averaged about $15,817 per property that VA sold during fiscal year 1987. (See exhibit V.) Nonetheless, our work shows that VA used the alternative in fewer than 1 percent of the fiscal year 1987 foreclosure cases at the nine offices we visited.

PMIs have similar programs to assist delinquent borrowers in avoiding foreclosure by selling their homes and, based on our discussions with the PMIs, they generally make frequent use of these programs. For example, one of the PMIs we interviewed told us that about 30 percent of its claims are settled through its home sales assistance program.

Voluntary conveyance of deed in lieu of foreclosure

Voluntary conveyance of the property deed is an expeditious means of terminating a delinquent loan. The veteran voluntarily conveys the property deed and is released from liability to repay the government for any claim VA pays as a result of the loan termination. In so doing, VA avoids the foreclosure process and is able to acquire the property more quickly and avoid costs, including interest, taxes, and legal expenses.

In September 1986 the VA Inspector General reported that VA could have saved about $16 million in fiscal year 1985 acquisition costs if it acquired more properties through voluntary conveyances of the property deed. Since that time, however, a smaller percentage of properties has been acquired under this alternative. For example, during fiscal year 1987, VA acquired 1,287 properties through voluntary conveyances--about 3 percent of all foreclosure cases in fiscal year 1987 and a 20-percent reduction from the prior year.

Based on our discussions with representatives of the VA offices we visited, the offices do not generally seek to obtain voluntary conveyances of the property deed, primarily because they want to hold the veteran accountable for the amount of the claim that VA pays the lender as a result of the loan termination. Our review of VA's debt collection performance shows, however, that VA typically collects only about 14 percent of the debt from veterans.

Further, in our May 1987 testimony, we pointed out that VA should determine whether it is feasible to accept voluntary conveyances of the deed based on a veteran's willingness to sign a promissory note to repay the debt. Recently, VA has encouraged its offices to accept the deeds with a promissory note, as appropriate, based on the advice of the regional VA District Counsels. Our ongoing work indicates that PMIs also will accept a deed in lieu with a promissary note, particularly in states that have a very long foreclosure process.

LEAST COST ANALYSIS NEEDED FOR EACH POTENTIAL FORECLOSURE

As we reported in our May 1987 testimony, VA offices generally did not provide information on VA foreclosure alternatives unless the veteran was aware of and requested information on them. In December 1987 the Congress passed the "Veterans Home Loan Program

Improvements and Property Rehabilitation Act of 1987," which now requires VA to provide information to defaulting veterans on the alternatives to foreclosure. This requirement should encourage more contact between VA and veterans, which could increase the use of the alternatives to foreclosure.

However, our work shows that VA regional offices have a great deal of latitude in determining how to deal with delinquencies and that no procedures are in place requiring VA offices to analyze and document a least cost approach for addressing these delinquencies. Although VA maintains that its offices consider foreclosure alternatives in handling each default, VA has not developed and documented a least cost analysis that compares the cost of the various alternatives. Such an analysis should consider the cost of the various foreclosure alternatives, including the government's interest costs and the probability of collecting any deficiency from the veteran.

If VA prepared and documented such an analysis it would promote accountability and a more systematic approach to servicing. To illustrate, we developed an analysis and applied it to the typical VA guaranteed loan in default in King County, Washington, using cost data and assumptions provided by the VA Seattle Regional Office. (See exhibit VI.) Our analysis shows that the cost savings from the use of the different alternatives could range from about $12,500 to about $21,000 per foreclosure in that county. Our purpose for conducting this analysis was to demonstrate that each foreclosure alternative has a cost associated with it, and that the savings associated with selecting the most appropriate alternative can significantly reduce VA's overall foreclosure costs.

VA STAFFING

The VA Task Force on Debt Prevention found that VA's current staffing level was insufficient to contact defaulting veterans and

recommended that funds be made available to hire fee personnel. Further, some regional VA officials we interviewed said that VA does not have adequate staff to effectively service its loans. The Director of the Loan Guaranty Program said that the cost to hire fee personnel to conduct servicing would be minimal compared to the projected savings. In this regard, he said that a 2 percent increase in the VA rate of curing delinquent loans would reduce foreclosures and the related losses by about $55 million.

Training is an additional area that VA could address in its efforts to upgrade its servicing capabilities. Only two of the nine offices we visited had a formal training program for its loan servicing personnel. Although VA headquarters recently began developing a training film, no ongoing VA-wide training program exists to instruct servicing personnel on a systematic approach to servicing to prevent foreclosure. The VA task force recommended that such a program be established.

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In closing, Madam Chairwoman, I would like to say that VA has recognized the seriousness of its foreclosure problem and has begun to take actions to emphasize some of its foreclosure alternatives and established the Task Force on Debt Prevention, to deal more effectively with the problem. In many cases, foreclosures are unavoidable and VA will continue to experience losses as will others in the mortgage insurance business. Nonetheless, through effective servicing and financial assistance, VA potentially can alleviate many delinquencies and reduce and/or avoid foreclosure costs through the use of foreclosure alternatives.

This concludes my prepared remarks. I welcome the opportunity to respond to any questions you or members of the Subcommittee may have.

EXHIBIT I

EFFECT OF VA FORECLOSURE ALTERNATIVES ON
THE FACTORS CONTRIBUTING TO VA'S
FISCAL YEAR 1987 PER-PROPERTY LOSS OF $15,817

		Effect by Program on Foreclosure Costs		
	Foreclosure costs	Refunding program	Compromise sales program	Deed-in-lieu program
Average Acquisition Cost Unpaid mortgage principal Delinquency amount Foreclosure expenses	$55,710	Decrease cost	Avoid cost[a]	Decrease costs[b]
Post-Acquisition Cost Taxes Special assessments Maintenance expenses Sales expenses Other expenses	$ 5,253	Avoid cost	Avoid cost	Same as foreclosure
Loss on Sale of Foreclosed Properties	$15,817	Avoid loss	Avoid loss	Decrease loss

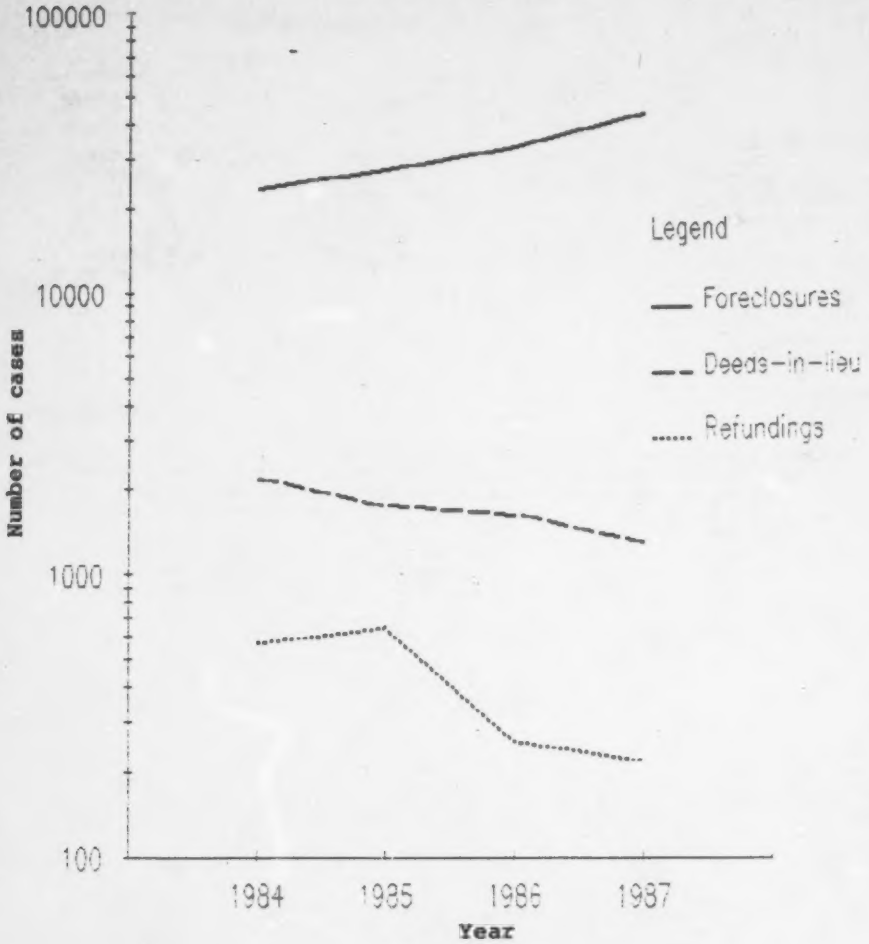
[a]On a compromise sale, VA does not acquire the property; however, VA does provide to the veteran the funds necessary to complete the sale. The amount provided is the difference between the amount the veteran receives from the sale and the amount the veteran needs to complete the sales transaction. (e.g., real estate broker fees and settlement costs.)

[b]VA still has to acquire the property, however, the cost to acquire is less because a deed in lieu of foreclosure is more expedient in states that have long foreclosure processes. Therefore, it reduces the delinquency amount and VA does not incur the foreclosure cost.

Source: Prepared by the General Accounting Office using VA data, March 1988.

EXHIBIT II

VA Use of Foreclosure Alternatives Compared to Foreclosures



The scale of this chart is not in equal increments.

Source: Prepared by the General Accounting Office using VA data, March 1988.

EXHIBIT III
VA FORECLOSURE ACTIONS AND LOSSES

	FY 1984	FY 1985	FY 1986	FY 1987
Number of foreclosures	23,377	27,276	33,022	42,029
Number of refundings	565	635	256	217
Number of compromise sales	unknown[a]	unknown	unknown	unknown
Number of voluntary conveyances	2,178	1,728	1,620	1,287
Average loss on acquired property	$10,784	$14,715	$14,391	$15,817

[a]VA had not developed a system to account for the number of compromise sales as of the end of fiscal year 1987.

Source: Prepared by the General Accounting Office using VA data, March 1988.

EXHIBIT IV

ANALYSIS OF THE INCREMENTAL COST ASSOCIATED WITH A REFUNDING FAILURE

Average monthly payment of a refunded loan		$ 544[a]
Average number of months between default and the lender's notice of intention to foreclose	3.4	
Refunding decision period (months)	1.0	
Total[b]		4.4 months
Average loss of a refunded mortgage failure (4.4 x $544)		$ 2,394
Average foreclosure loss on property acquired in fiscal year 1986		$14,391
Success-to-failure ratio ($14,391 to $2,394)		1 to 6

[a]Average acquisition value in fiscal year 1986 ($53,883) at 9 1/2 percent for 30 years and the average monthly tax payment.

[b]According to the provisions of 38 C.F.R. 36.4318 the refunding decision should be made within 30 days after the lender has notified VA of its intention to foreclose or unless other arrangements have been made with the lender.

Source: Prepared by the General Accounting Office using VA data, March 1988.

EXHIBIT V

ANALYSIS OF VA'S FISCAL YEAR 1987 LOSSES
ON SALE OF FORECLOSED PROPERTIES

	Average per property		Total on all properties sold (millions)	
Cost to Acquire Properties		$55,710		$1,637
Post Acquisition Cost				
(1) Taxes	$ 744		$22	
(2) Special Assess.	55		1	
(3) Maintenance	802		24	
(4) Sales Expenses	2,506		74	
(5) Other Expenses	1,146	5,253	34	155
Total Cost to Acq. & Sell		$60,963		$1,792
Less Selling Price		(45,146)		(1,327)
Loss on Sale of Foreclosed Properties		$15,817		$ 465

Source: Prepared by the General Accounting Office using VA data, March 1988.

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EXHIBIT VI

Comparison of Estimated VA Costs on VA Foreclosure Alternatives and Foreclosure for the Typical Property in King County, Washington

Compromise sale	$13,313
Deed-in-lieu	$20,247
Refunding	$21,392
Foreclosure	$34,063

Source: Prepared by the General Accounting Office using data gathered from VA's Seattle Regional Office, March 1988.

Two major factors included in our analysis, which VA does not consider, are: (1) VA's imputed interest cost for the period it owns the acquired property and (2) the probability of collecting the debt assessed the veteran based on VA's historical debt collection experience.

STATEMENT OF

THE NATIONAL ASSOCIATION OF HOME BUILDERS

before the

COMMITTEE ON VETERANS AFFAIRS

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

on

THE VA HOME LOAN GUARANTY PROGRAM

March 17, 1988

Madam Chairwoman and Members of the Subcommittee:

My name is Martin Perlman and I am Vice President and Treasurer of the 150,000 member National Association of Home Builders. I am a builder from Houston, Texas and have been active in the VA Home Loan Guaranty Program for more than 20 years.

NAHB is a trade association of the nation's homebuilding industry with almost 20% of our builder members involved in building housing financed under the Veterans Administration (VA) housing programs. According to NAHB's "Profile of the New Home Buyer," the VA Home Loan Guaranty Program was used by 13.3% of new single family home buyers in 1987.

Madam Chairwoman, I am pleased to present our views on the long term solvency of the VA Home Loan Guaranty Program. I would also like to comment on the Administration's FY'89 budget proposals and legislation establishing an Independent Commission on the VA Home Loan Guaranty Program, S.2049.

PROGRAM GROWTH

First, I would like to take this opportunity to address the Veterans Home Loan Guaranty Program overall. The program was initiated shortly before the end of World War II to help veterans returning from the war obtain homeownership. Because of their military service, veterans were unable to establish a credit record making it difficult to purchase a home. The VA

entitlement has allowed veterans to purchase 12.7 million homes, totalling $306 billion since 1944. I had the honor of representing NAHB at the ceremonial closing of the 12 millionth loan last year in Phoenix, Arizona. We are proud of the partnership we have had with the Veterans Administration in providing homeownership opportunities for veterans who have so ably served our country in the Armed Forces.

Madam Chairwoman, we support the action taken by Congress last year in passing one of the most comprehensive bills to improve the home loan program since its inception and appreciate your leadership role in making this possible. Key among these improvements were an increase in the loan guaranty amount in high cost areas, exemption from the sequestration provisions of the Deficit Reduction Act, direct review of appraisals by automatic lenders, liberalization of refinancing restrictions, use of state data for residual income purposes, a downpayment on mobile homes and mandatory underwriting on assumptions.

ENTITLEMENT NATURE OF PROGRAM

Loan Guaranty Revolving Fund

Madam Chairwoman, before commenting on the specific proposals you asked us to explore to improve the VA Home Loan Guaranty Program, I would like to comment on the entitlement nature of the program and the need to provide appropriations for the Loan Guaranty Revolving Fund.

It is important that the VA Home Loan Guaranty Program be sustained and run in an efficient manner. It is also important, however, that the entitlement nature of the program be acknowledged when seeking program improvements so that this VA benefit will continue to be effective in attracting qualified men and women into the service.

Due to the economic downturn in many of our oil producing states, a number of VA homes have been foreclosed. This followed a period of record high interest rates and earlier downturns which occurred in the Great Lakes states and other parts of the

country. Such cycles can cause an increase in the level of losses to lenders and to the Loan Guaranty Revolving Fund. However, we do not believe that temporary increases in foreclosures or downturns in certain parts of the country should lead to a cutback in the benefits of the program. Instead, Congress should focus on the long term goals and performance of the VA Home Loan Guaranty Program and evaluate program changes on this basis.

Such a review must recognize that the nature of an entitlement program is fundamentally different from that of traditional financing programs, and requires a higher level of commitment from Congress. Therefore, while NAHB continues to support deficit reduction as a means of keeping interest rates down and of creating a stable economic environment, we believe it is important that the Loan Guaranty Revolving Fund be supplemented by appropriations when necessary. We urge Congress to appropriate the required funds needed to sustain the program so that veteran homebuyers will not be denied homeownership opportunities.

Congressional funding to run the program is not new. From the program's inception, until 1962, the VA Loan Guaranty Program was funded through appropriations. From that time, up until the last few years, the program was basically self-sustaining.

We urge that any review and analysis on the sound operation of the program in the future be carefully done without jeopardizing the entitlement nature of the VA guaranty, since the program continues to assist the people it was intended to serve. In the interim, it is important to continue to support appropriations for the program and to oppose increased fees to supplement the fund.

Funding Fees

Madam Chairwoman, we appreciate your commitment to looking at other alternatives to the one percent fee. We were also reluctant to support a two-year retention of the existing one

percent funding fee last year to supplement the Loan Guaranty Revolving Fund and to assist in reducing the federal deficit.

While we are pleased that a fee increase has not been proposed for FY'89, and that past fee increase proposals have been rejected, Congress needs to address the piecemeal approach of funding the guaranty program with incremental fees, which erode the entitlement nature of the program.

SUBCOMMITTEE PROPOSALS

Madam Chairwoman, we recognize your concerns in seeking to develop long term solutions to restore solvency in the VA Home Loan Guaranty Program. You have asked us to comment on a number of possibilities to make the program self-sustaining including: renting foreclosed properties in economically depressed areas until home prices improve; the benefits of mortgage insurance versus the current one percent funding fee; the setting up of an insurance pool which could be invested and; maximizing the government's return on its loan assets either through sales or holding them for collection of interest.

Renting Foreclosed Properties

Madam Chairwoman, It was a pleasure for me to testify before this Subcommittee in Houston last July, supporting the renting of foreclosed property as an alternative to selling homes at a loss in distressed areas.

Holding the properties in the Veterans Administration portfolio and putting them on the market for a temporary period as rental units rather than selling them below market would accomplish several things: it would provide housing for citizens who cannot afford to buy; it would not disrupt the marketplace and; it would allow the government to sell properties over time as real estate values improve.

When I testified last year, I was faced with the possibility of shutting down Perl Homes, which later occurred, because I was put in the position of competing with foreclosed properties that were being sold by auction at 50% or more of current sales

prices. Even in the presence of high apartment vacancy rates, however, I have been able to rent the homes in this same subdivision.

While Congress has taken steps to limit auctions as a last resort, the Houston Chronicle reported that a VA auction will be held in the area in early April. We are concerned that auctions and the new property disposition plans being considered by Congress and the VA may again adversely affect the new homebuying market. The intent is to make the disposition of VA acquired properties more saleable in depressed market areas, but care should be taken to avoid the "dumping" of properties which would make new home sales noncompetitive.

I am pleased that you are considering the option of renting foreclosed properties as an alternative and look forward to the comments of others who are testifying here today.

Mortgage Insurance/Insurance Pool

The concept of mortgage insurance is based on the principle of actuarial soundness. Mortgage insurance premiums reflect actual and anticipated performance of a loan portfolio. Underwriting standards for the property insured and the creditworthiness of a borrower are designed to define the limits of an insurer's risk. Mortgage insurance premiums may be collected either over the life of a mortgage or up front. Premiums are invested in a variety of instruments to provide short term liquidity and long term income. Careful planning is required to balance anticipated obligations with current premium income.

Inherent in the mortgage insurance approach is the notion that premiums will be set at a level that will compensate an insurer for assuming the risk of borrower default. For private mortgage insurers, premiums must be set at a level that will also produce dividends for stockholders. In a mutual mortgage insurance fund the premium is set to cover all costs and provide some additional benefits to the participants.

The VA Loan Guaranty Program, on the other hand, is an entitlement program. As we have emphasized, the Loan Guaranty Program is based on the assumption that the government is compensated by the veteran's service to our country and earned entitlement to the benefit of the program. While the veteran must meet underwriting standards which limit the risks to the VA, the program thrust is to help a veteran buy a home. A veteran is not asked to compensate the government for assuming a portion of the risk if the veteran defaults, nor does the current one percent funding fee compensate the government for assuming the risk.

The cure for the current level of losses does not lie in changing the nature of the program from entitlement to actuarial soundness, as fees would have to be substantially raised, taking away the entitlement nature of the program.

Maximizing Return on Loan Asset Sales

We are concerned with the Administration's policy decision to sell the loan assets of the VA and other federal agencies. Our concern is with the overall impact of the proposal upon the long term economic health of the various programs. In deciding which assets to sell, careful consideration must be given to assessing the true value of the income stream of the asset being sold. Short-term gain in deficit reduction must be balanced against the long-term loss of the income stream in determining the actual "value" of the asset sale and the long-term implications and loss to the program.

Loan assets sold without a VA guaranty (nonrecourse) may need some form of credit enhancement which can be expensive. The VA had a nonrecourse offering of loans in its foreclosed property portfolio in the spring of 1987 with bids ranging from as low as 14 cents to 67 cents on the dollar. While the VA did not accept any of these offers, a nonrecourse sale presents many problems. The loans being sold are by definition loans made to finance the disposition of properties acquired by the VA because a veteran went into default. By the very nature of their location such

properties make capital investors wary. Additionally, the loss of the income stream for the Loan Guaranty Revolving Fund only increases the pressure for additional appropriations.

ADMINISTRATION'S FY'89 BUDGET PROPOSALS

Madam Chairwoman, I would like to comment on the Administration's FY'89 Budget as it affects the VA Home Loan Guaranty Program, including federal credit reform and elimination of the administered rate.

Federal Credit Reform

The National Association of Home Builders strongly opposes credit reform measures which attempt to restrict federal mortgage credit activities of the Veterans Administration and other government housing programs. The credit reform legislation supported by the Administration would change the way federal credit programs are treated in the budget. It would require federal agencies to seek direct appropriations from Congress equal to the difference between what private sources would charge for the loan and the fee charged by the government. This approach overstates the cost of the program and reflects the Administration's position that the federal government should have a limited role in providing housing assistance. We reject this proposal and urge Congress to oppose it also, since this is yet another attempt to restrict federal housing credit. For veterans the entitlement nature of the program is also ignored.

Negotiated Rate

The Administration intends once again to seek authority for negotiated interest rates on VA guaranteed mortgages. This would eliminate the administratively set VA interest rate and allow for a negotiated rate between the buyer and the lender.

NAHB repeatedly has voted to support the administratively set rate. At our convention in January, a negotiated interest rate was again debated and voted down by our Board of Directors. NAHB has long endorsed the VA's ability to set the program interest rate, in order to protect the interests of the veteran

and the guaranty fund. We believe the administratively set rate will give veterans a better opportunity to obtain homeownership.

Furthermore, because of its sensitivity to market conditions, the VA prevailing rate continues to be an important national benchmark for mortgage interest rates. If the VA's authority to set a maximum interest rate ceiling were eliminated, the credit markets would lose this stable measure of the cost of mortgage credit, a feature which becomes even more important in a volatile interest rate environment.

For these reasons, we continue to support the administratively set interest rate for VA buyers.

LEGISLATIVE PROPOSALS

Adjustable Rate Mortgages

Madam Chairwoman, we thank you for your effective leadership in passing a pilot program for an adjustable rate mortgage (ARM) in the House of Representatives last year. We regret that this valuable mortgage instrument was dropped in conference when the VA bill passed last December. This ARM was to be patterned after the Department of Housing and Urban Development's ARM, which limits its interest rate increase to 1% per year with a cap of 5% over the life of the loan. NAHB continues to strongly support authority for the VA to guarantee ARMs. This is a very helpful mortgage instrument, since it could save a veteran about $100 a month on the average VA loan. It also enables more veterans to qualify in times of high interest rates, as well as allowing veterans a rate decrease without refinancing.

We urge the Congress to support authorization for the VA to offer this type of mortgage instrument, since the VA is the only major market participant without an ARM. NAHB would be willing to work with the VA to develop information about the performance of ARMS to address the concerns of veterans groups about the safety and soundness of an adjustable rate mortgage.

Loan Guaranty Amount

First, I would like to thank you for your timely action in passing S.2022 which clarified and maintained the maximum level of benefit for which a veteran is entitled under the home loan program. We are concerned, however, that last year's legislation reduces the loan guaranty amount that a veteran may receive at the lower end of the scale when he initially uses his entitlement. For example, on a $55,000 loan the veteran previously was allowed a guaranty of $27,500, but under the new formula he is limited to $22,500, a $5,000 decrease. If the guaranty amount were raised to 60% of the loan amount, or $36,000, which is the same as the Senate passed bill last year, the veteran would receive a guaranty amount of $33,000 (Attachment A). We hope that Congress will assess the impact of the new formula on the lower end of the market so that these veterans will not be denied homeownership opportunities.

Independent Home Loan Guaranty Commission

Earlier in the month we testified before the Senate on S.2049 in support of creating an Independent Commission on the VA Home Loan Guaranty Program. The Commission's charge is to look into ways of improving solvency in the Loan Guaranty Revolving Fund, improving program benefits and assistance to veterans, reducing defaults and foreclosures, and disposition of VA properties in a cost effective manner.

We commented on the following areas where we feel the Commission should act: solvency in the loan guaranty revolving fund while maintaining the entitlement nature of the program; the piecemeal approach to placing fees on VA home loans; alternative mortgage instruments; the loan guaranty amount and the impact of property disposition efforts on new construction. A Commission would lend itself to addressing these and other concerns surrounding the program. We urge you to consider the establishment of a Commission which could provide other alternatives to make improvements in the VA Home Loan Guaranty Program.

CONCLUSION

In conclusion, we hope that careful analysis will be given to retaining the entitlement nature of the VA Home Loan Guaranty Program while trying to streamline it and make it self-sufficient. Congress and the Administration must continue the responsibility of providing assistance to veterans for the purchase of housing.

Thank you for allowing us to present our views. I would be pleased to respond to any questions you may have.

ATTACHMENT A

LOAN AMOUNT	60% up to $27,500 (Current Law)	40% up to $36,000 on loans above $45,000 with a $22,500 floor or 50% on loans of $45,000 and below (Compromise Agreement)	60% up to $36,000 (1987 Senate Bill S.9 S.1891)
$ 144,000*	$ 27,500	$ 36,000	$ 36,000
$ 135,000	$ 27,500	$ 36,000	$ 36,000
$ 125,000	$ 27,500	$ 36,000	$ 36,000
$ 115,000	$ 27,500	$ 36,000	$ 36,000
$ 105,000	$ 27,500	$ 36,000	$ 36,000
$ 95,000	$ 27,500	$ 36,000	$ 36,000
$ 85,000	$ 27,500	$ 34,000	$ 36,000
$ 75,000	$ 27,500	$ 30,000	$ 36,000
$ 65,000	$ 27,500	$ 26,000	$ 36,000
$ 55,000	$ 27,500	$ 22,500	$ 33,000
$ 45,000	$ 27,000	$ 22,500	$ 27,000
$ 35,000	$ 21,000	$ 17,500	$ 21,000
$ 25,000	$ 15,000	$ 12,500	$ 15,000

* GNMA generally limits eligible securities to four times the loan guaranty amount ($36,000 x 4 = $144,000)

Source: Compiled by the National Association of Home Builders, Government Affairs Division

Tuesday, March 8, 1988 Houston Chronicle

HUD, VA said to be 'dumping' homes here

Sales will hurt values, real estate pros say

By RALPH BIVINS
Houston Chronicle

Two federal agencies plan to auction hundreds of repossessed homes in Houston over the next 30 days, a tactic that worries some real estate professionals who fear this "dumping" of properties on the city's already ailing market will further depress residential real estate prices.

The U.S. Department of Housing and Urban Development is offering 730 repossessed houses in its "Super Tuesday" sale at the Viscount Hotel today, officials said. The HUD houses not sold at Tuesday's written-bid sale will be sold at an open auction on March 25, 26 and 27, said Tom Moore, supervisor of HUD's single-family department in Houston.

About 325 VA-owned houses in Houston will be sold at auctions early in April — the first VA auction since last summer.

"It's just dumping properties on the market," said Lily Doovema, chairwoman of the VA Advisory Council, a group of volunteer real estate professionals. "I feel this is very poor for our economy and our state for our government to dump properties on the market."

The agencies suspended open auctions last year and began selling repossessed houses to buyers who submit written bids through real estate agents.

Moore said the Super Tuesday sale and the subsequent auctions bring out prices that are a true representation of Houston housing market.

"No, we're not dumping. We're selling at whatever the market will bear," Moore said. "The market sets the value — not HUD."

HUD owns about 5,300 repossessed houses in a 35-county South Texas region. About 75 percent of those are in Harris and Fort Bend counties, Moore said.

It costs HUD about $20 per day to keep a house in its inventory because of costs for maintenance, interest payments, and losses to vandalism, Moore said.

"The longer we hold it in inventory, the more it costs the U.S. government," Moore said.

HUD plans two other auctions in 1988, along with weekly written bid sales. HUD expects to gain $325 million to $350 million in revenue from the sale of as many 8,000 repossessed Houston-area houses, Moore said.

Jim DeLaPlaine, president of the Greater Houston Builders Association, said the sale of foreclosed homes by HUD and VA brings down the value of homes near the repossessed properties.

"We think they would do better to fix them up and rent them out for a while," DeLaPlaine said. "All you do is encourage more foreclosures in the neighborhood."

VA and HUD houses are usually resold at 55 percent to 60 percent of the appraised value of the house, DeLaPlaine said.

"If you sell trash, you are going to encourage more trash. We think the auction is not in the best interest of the community."

The National Association of Home Builders voiced opposition to VA auctions at a U.S. Senate hearing in Washington last week.

The VA, which owns 7,900 houses in its South Texas region, believes the open auction is an acceptable selling tool, said Mike McReacken, VA loan guaranty officer in Houston. The VA auction will liquidate some of the agency's oldest houses in its Houston-area inventory, some of which have been held by the VA for more than a year.

The HUD and VA auctions will have minimum bid prices. HUD will pay real estate agents a 3 percent commission, and VA brokers will split the 3 percent commission with the outside auctioneer company — Larry Latham Auctioneers Inc.

Buyers will have to pay cash for the homes or obtain financing from a mortgage company. Officials suggest that bidders apply to the mortgage companies for loans before the auction.

VA bidders will be required to pay 10 percent down and will need a $2,000 cashier's check to enter a bid, Latham said. Bidders for the HUD auction will be required to pay $100 down. Some of the HUD houses will qualify for a mortgage backed by Federal Housing Adminstration.

Most of the VA houses will be in need of some repairs, Latham said. "The properties we get are ones that have been on the market for several years."

Pam Minich, senior project director at CDS Research Inc. of Houston, said widespread sales of foreclosed houses hurt new home sales. "Obviously it takes away some demand that might go to new homes. It sort of drags the whole pricing structure down."

She said the sales of new houses priced under $75,000 were particularly hurt by the foreclosure competition, but the ripple effect hurts sales of more expensive homes as well.

But Barton Smith, chairman of the economics department at the University of Houston, said anything — including auctions — that will get occupants into the government-owned houses is desirable.

"It's a heck of a lot better than having these houses vacant for two or three years," Smith said. "I think the notion that auctions depress prices is nonsense."

The excess supply of housing has caused declining prices in Houston, Smith said.

Arthur L. Wright of the Real Estate Center at Texas A&M University said analysts should consider the resale of foreclosures as a part of today's marketplace. Population growth is needed to overcome the housing glut, he said.

National Association of Home Builders

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Martin Perlman
Vice President/Treasurer

Reply to:
Perl Homes, Inc.
10555 NW Freeway, Suite 131
Houston, TX 77092

April 8, 1988

The Honorable Dan Burton
U. S. House of Representatives
120 Cannon House Office Building
Washington, D.C. 20515

Dear Representative Burton:

It was a pleasure to testify before the Subcommittee on Housing and Memorial Affairs on March 17, on the solvency of the VA Home Loan Guaranty Program. I would like to take this opportunity to further expand on our conversation at the hearing on how to keep veterans in their homes to stem the increased foreclosures in economically depressed areas.

I view the problem as twofold and recommend a three part solution. First, the major problem is economic with the veteran losing his earning capacity or incurring substantial salary reductions due to the market conditions in his particular part of the country. This alone may cause substantial foreclosures of property.

There is an additional problem, however, which causes a "domino" effect on the marketplace. When the Veterans Administration sharply reduces home prices or sells them at auctions on a bargain basis, it reduces the value of the home next door and other properties in the surrounding area. A veteran, for example, who has $60,000 left to pay on his loan with no hope of recapturing his equity would certainly consider walking away. It makes no sense for him to continue making payments on his loan which may only be worth 50% of its original value due to the VA's "dumping" practices. This adds more homes to the VA's foreclosure portfolio which compounds an already growing inventory problem in areas of economic distress.

I recommend three possible solutions:

First, I would reduce interest rates on loans for veterans, who are in financial trouble. This could be done on a case by case basis, coupled with financial consultation. In this manner, help would be made to the veteran before foreclosure occurs. This would be more effective than the Senate VA Committee's proposal to reduce interest rates on loans made to sell properties already in foreclosure, where the buyer does not have to be a veteran to qualify.

Second, a short term forbearance in the form of a moratorium should be considered in cases of financial crises. The VA bill passed last December (P.L. 100-198) calls for greater counseling regarding alternatives to foreclosure and this may be another tool to assist the veteran in retaining his home.

Third, as I testified, foreclosed properties should be rented until home prices improve so that the market will remain stable. This would act to stop decline in home values in the surrounding area and assist in alleviating the "domino" effect. It would also provide housing for those who cannot afford to buy. Homes that I was not able to sell in the Houston area due to the VA's "dumping" policies, I was able to rent to needy families seeking affordable shelter.

I appreciate your genuine concern in seeking to help veterans save their homes. This will help stem the rising number of foreclosures which have predominated in economic depressed areas of our nation. Please let me know if I might be of further assistance.

Sincerely yours,

Martin Perlman
Vice President and Treasurer

MP/vg

STATEMENT OF

ROBERT M. O'TOOLE
STAFF VICE PRESIDENT
RESIDENTIAL FINANCE AND GOVERNMENT AGENCY RELATIONS

of the

MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

SUBCOMMITTEE ON HOUSING
COMMITTEE ON VETERANS' AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

Oversight Hearing on

The Solvency of the Veterans' Home Loan Guaranty Program

March 17, 1988

Madam Chairwoman and members of the Subcommittee, I am Robert M. O'Toole, Staff Vice President for Residential Finance and Government Agency Relations of the Mortgage Bankers Association of America (MBA).* Accompanying me today are Burton C. Wood, MBA's Legislative Counsel, and Linda K. Bumbalo, MBA's Associate Legislative Counsel.

MBA appreciates the opportunity to appear before you today to testify on the solvency of the Veterans' Administration (VA) home loan guaranty program and on ways to make the Loan Guaranty Revolving Fund self-sustaining over the long term, an issue that is of vital concern to all participants in the guaranty program.

Before addressing that issue, however, Madam Chairwoman, MBA wishes to express its appreciation to you and to the House Veterans' Affairs Housing Subcommittee for the consideration given in 1987 to the concerns expressed by the mortgage banking industry about the VA home loan guaranty program and for the passage of the "Veterans' Home Loan Program Improvements and Property Rehabilitation Act of 1987," PL 100-198. MBA supported PL 100-198 and was most pleased that Congress acted expeditiously on it.

MBA applauds the action, taken in PL 100-198, to increase the maximum guaranty amount to $36,000. The guaranty had not kept pace with the ever-increasing costs of homeownership, inasmuch as it had not been increased since 1980. MBA believes that increasing the maximum guaranty amount will assist those veterans living in high-cost housing areas to become homeowners. However, we are concerned that the sliding-scale nature of the new formula may reduce homeownership opportunities for veterans purchasing homes in low-cost areas. MBA will monitor this situation and report to the Subcommittee if problems arise.

MBA is also pleased that Congress did not increase the VA home loan funding fee from 1 percent to 2.5 percent as proposed by the Administration in its FY 1988 budget. While MBA opposes user fees for the home loan guaranty program because it is a benefit to which every veteran is entitled, MBA also recognizes the necessity for this temporary measure.

In addition, MBA is pleased with the provision in PL 100-198 that permits appraisals made by VA fee appraisers to be sent directly to VA automatic lenders to make the determination of reasonable value. This will both expedite the loan processing time and relieve overburdened VA staff from unnecessary paperwork so that VA staff can concentrate on functions that only the VA can perform. However, MBA would like to urge that the VA be encouraged to move as expeditiously as possible in carrying out this provision. There are many standards currently in use in the marketplace that the VA could use as models, thus the agency does not have to delay in setting new standards.

MBA is also grateful for the provisions in PL 100-198 that amended the application of the no-bid (a no-bid is a foreclosure of a VA-guaranteed home loan where the lender is required by the VA to acquire the property under the "no-bid" formula established by law, based on the amount of the veteran's debt and the property's value) calculation in instances where a case is tipped into a no-bid because of the accrual of interest during periods of delay in the foreclosure sale. These include delays caused by the VA not being prepared for the scheduled sale, by lender forbearance at the request of the VA, and by voluntary bankruptcy. MBA emphasized that lenders were being unfairly penalized in those cases because, absent the delays, the property never would have been left with the lender.

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of housing and other real estate finance. MBA's membership comprises mortgage originators and servicers, as well as investors, and a wide variety of mortgage industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, selling, and servicing real estate investment portfolios. Members of MBA include:

- o Mortgage Banking Companies
- o Commercial Banks
- o Mutual Savings Banks
- o Savings and Loan Associations
- o Mortgage Insurance Companies
- o Life Insurance Companies
- o Mortgage Brokers
- o Title Companies
- o State Housing Agencies
- o Investment Bankers
- o Real Estate Investment Trusts

MBA headquarters is located at 1125 15th Street, N.W., Washington, D.C. 20005; telephone: (202) 861-6500.

MBA believes that Congress intended in PL 100-198 to address specifically those cases where accrued interest, caused by delays, tipped the property into a no-bid situation. The legislative language leaves to the Administrator the obligation to pick a date earlier than the liquidation sale date for interest accruing on the veteran's debt to cease for no-bid calculation purposes in those cases of VA-requested forbearance and voluntary bankruptcy where the delay has been "excessive." MBA has urged the VA to carry out Congressional intention in regulations by defining "excessive" delay in cases of VA-requested forbearance and voluntary bankruptcy to mean a delay which causes a VA property acquisition to become a no-bid solely because of the interest accrued during the delay. This definition permits the claim payment formula on delayed foreclosure sales to be calculated on a case-by-case basis to target those delayed sales that the legislation was designed to help.

MBA is concerned about a possible interpretation of the legislative language that would stop interest rate accrual in all cases involving forbearance and bankruptcy—not just those cases resulting in no-bids. Such an interpretation would leave lenders in a worse position than before the Act and would add to losses rather than curtail losses in certain instances as the legislation intended. MBA urges that, if the VA issues regulations that apply this provision in all cases, then the Congress should take action. Congress should adopt legislation which prohibits the Administrator from setting a date earlier than the liquidation sale date for the cessation of the accrual of interest in those cases of VA-requested forbearance and voluntary bankruptcy where the VA would acquire the property on the sale date because the net value of the property securing the loan exceeds the veteran's indebtedness (including accrued interest during the delay) minus the guaranty amount. Adoption of this interpretation—by regulation or legislative clarification—would ensure that mortgage lenders who participate in the VA home loan guaranty program are not worse off under legislation that was intended to offer relief.

Reinstatement of Partial Entitlement

MBA appreciates the swift action taken by Congress in passing the "Veterans' Home Loan Program Emergency Amendments of 1988," S 2022, which restores a fixed maximum entitlement, i.e., $36,000, for every veteran so that an individual veteran's remaining partial entitlement for a guaranty is not a function of the amount of the loan for which the veteran is applying.

THE VA HOME LOAN GUARANTY PROGRAM

The VA home loan guaranty program is an entitlement program established under the Serviceman's Readjustment Act of 1944 to help qualified veterans achieve homeownership. The program provides two primary benefits to qualified veterans. First, the VA guarantees a portion of the veteran's mortgage principal up to a maximum of $36,000. Because of this guaranty, mortgage lenders are able to provide veteran homebuyers with financing at a lower cost than would be available without the program. The second benefit offered by the program is the stipulation that no downpayment need be required by the lender. A veteran, therefore, is able to get a "100 percent loan."

Since the VA initiated its program in 1944, 12.4 million loans have been guaranteed under the VA home loan guaranty program. The vast majority of those loans have cost taxpayers only the administrative cost of processing the initial approval. The total principal amount of the more than 12 million guaranteed loans over the life of the program is $304 billion. Veterans have proven to be good credit risks. Through December 1987, 7.8 million guaranteed loans, totaling $125.1 billion, have been paid in full.

The budgetary mechanism for the loan guaranty program is the Loan Guaranty Revolving Fund, which was established to balance the income and expenses associated with operating the program. Income for the Revolving Fund is derived primarily through the sale of "vendee" loans, which are direct loans made by the VA to finance the sale of VA-acquired properties. Other sources of income are the downpayment funding fee, income from the loan portfolio, and appropriations. Expenses incurred by the Revolving Fund are predominantly for the acquisition of foreclosed properties securing guaranteed loans. Because of severe economic and market conditions in some parts of the country, there has been a significant increase in the number of foreclosures of VA loans.

In the past, when the Revolving Fund was in a deficit position, the VA transferred earnings from its Direct Loan Revolving Fund (DLRF). The DLRF was created in 1950 to make direct loans to veterans who lived in areas with housing credit shortages and could find no private lender to make VA-guaranteed loans. In these cases, the VA acted as lender, and the interest on the direct loans provided the VA with net earnings in the DLRF.

However, in the early 1980s a number of changes were made which diminished the role of the DLRF as a source of income for the Revolving Fund. In 1981, the VA was instructed by the Administration to make no more direct loans except to severely disabled veterans for specially adapted housing. In 1982, the Administration began a policy of selling Federal assets, which has resulted in the sale of most of the portfolio of direct loans held by the DLRF.

SALE OF VENDEE LOANS

Throughout the 1980s, the Administration has continued to push the sale of Federal assets and has proposed to sell all vendee loans without recourse. To that end, the Administration's FY 1988 budget indicated that the VA would sell vendee loans in all cases without recourse. An attempt by the VA in the spring of 1987 to have such a sale was not successful. Subsequently, legislation was passed that imposes constraints on the VA's ability to make nonrecourse vendee loan sales. PL 100-136, enacted on October 16, 1987, effectively requires the Administration to sell vendee loans with recourse, because loans can be sold without recourse only for the amount of the loan's unpaid balance. The Administration's proposed FY 1989 budget states that beginning in the second half of FY 1988, all loans will be sold without recourse, and that by the end of FY 1989, the VA will sell $861 million of its loan portfolio. The Administration has indicated it intends to submit legislation that would enable it to do this.

The sale of vendee loans without recourse shifts the credit risk to the private purchasers, who necessarily adjust their purchase prices accordingly. It can be expected that the reduction in the sales price paid to the government will be greater than any savings it might realize by transferring the risk of default.

It is important to note that vendee loans sold with recourse can be put into pools backing Government National Mortgage Association (GNMA) mortgage-backed securities. If these loans are sold without recourse, it is doubtful whether they could be put into GNMA pools. This means the loans would be sold at outrageously low prices.

MBA opposes such action, as it would not be in the best interest of the Loan Guaranty Revolving Fund over the short and long terms. Sales of vendee loans with recourse maximize the government's return.

Prior to October 1, 1987, the VA was authorized to finance up to 75 percent of its sales of VA-acquired properties with vendee loans. The number of authorized vendee loans has been reduced to 65 percent, but not less than 50 percent, of sales. MBA urges that the quota concept be removed, and that the VA be allowed to use vendee loans as fully as it deems economically advantageous in selling properties acquired through foreclosures.

FUNDING THE PROGRAM

The funding fee paid by the veteran is a temporary fee necessitated by the change in the balance sheet of the Revolving Fund. With the loss of income derived from direct loans, the need for new sources of income arose. Initially established at 0.5 percent, the fee was increased to 1 percent in 1984 and was extended in PL 100-198 for two years until September 30, 1989. Attempts by the Administration to increase this fee have failed. The budget proposal for FY 1988 had asked for a 2.5 percent fee.

Clearly, the issue of alternatives to the funding fee needs to be addressed. The funding fee is known to be a temporary one and is not looked upon favorably by Congress, lenders, and veterans. However, the basic question that needs to be answered is whether Congress intends the VA home loan guaranty program to continue as an entitlement program. A positive answer to that question precludes any discussion of making the program actuarially sound. If Congress reaffirms the entitlement nature of the program, then it is incumbent upon Congress to acknowledge that the program, given its framework, may require appropriations. The Loan Guaranty Revolving Fund has never been self-sustaining, but depended each year upon transfers of funds from the DLRF. Making the Revolving Fund self-sustaining will require new approaches.

It is important to point out that programmatic changes have been made in recent years that should favorably affect the Revolving Fund. There are now stricter underwriting guidelines for borrowers, which have been extended to assumptors of VA-guaranteed loans. Efforts to offer financial counseling to veterans who are delinquent on their loans are intended to reduce the number of foreclosures and losses. Another change is the strengthening of qualifications of appraisers. It is too soon to assess the cumulative effects of tightening up the program. But these changes should have a positive impact on the program.

In addition to the transfers from the DLRF, the Revolving Fund also benefitted in the past from the effects of inflation in home prices. In the case of foreclosures, the VA was protected from losses when it acquired and subsequently disposed of properties because the home sold for more than the amount of the mortgage debt. Inflation enabled the VA to recoup its expenses.

It is probable that the current low inflationary environment will persist for the foreseeable future. This is an important factor, given the no-downpayment feature of the VA guaranty program. If there is no equity in the home due to the no-downpayment feature and no equity is created due to the absence of inflation, the VA cannot look to the property to cover any losses suffered by it when foreclosure occurs. This phenomenon needs to be recognized and dealt with.

Insurance

Inevitably a broad discussion of recommendations regarding the solvency of the Revolving Fund must lead to the topic of mortgage insurance. If the Congress decides that the VA home loan guaranty program should be changed from an entitlement program, where the Federal government guarantees payment to the lender of only a portion of the loan, to a mortgage insurance program where the lender is assured of payment of the full loan amount, then the costs of the program will increase. An indigenous characteristic of an insurance program is the sharing of risks and of costs by the insured. The cost, therefore, of any mortgage insurance would be borne by those veterans whose loans would be insured.

The Federal Home Administration (FHA) is an actuarially sound insurance program. The Mutual Mortgage Insurance Fund (MMIF) is the reserve fund that covers primarily the FHA homeownership program. Borrowers pay premiums that are used to cover costs, with the remainder placed in the MMIF, which currently has more than $4 billion in reserves. Thus, the cost of providing the service that FHA offers, mortgage insurance, is fully covered at present by fees. FHA was established in 1934 and took a decade to become actuarially sound.

The difficult issue with converting the VA guaranty program to an insurance program is that the costs for those who need the program most would increase. For many veterans, the loan guaranty program is the only way for them to get their foot in the homeownership door.

Not to be overlooked is that if the VA program were to be designed to be actuarially sound, then it would be very much like FHA. Except for the no-downpayment feature, there would be little distinction between the two programs. It is conceivable that the possible long-term effect of a decision by Congress to treat the VA loan program as an insurance program would in fact be the demise of the VA loan program.

PROGRAM MANAGEMENT

Efficiencies in program management and sound financial decisions with a long-term perspective could not but help the solvency of the Revolving Fund. Among these are inadequate VA staffing and equipment.

MBA believes that Department of Veterans' Benefits staffing over the past several years has been insufficient to handle the volume of defaults and foreclosures. For example, the number of seriously delinquent VA loans rose to 140,558 in the first quarter of FY 1988, as compared with 119,717 in the first quarter of FY 1986. Additionally, the number of VA loans foreclosed in the first quarter of FY 1988 rose to 11,568, as compared with 6,908 in the first quarter of FY 1986. Particularly in the areas where foreclosure volumes are high, such as Houston and Denver, many foreclosure sales have had to be postponed because the VA did not have adequate staff to analyze the property appraisals and issue foreclosure bidding instructions. These postponements increase the veteran's debt and cause unnecessary losses for the VA and the lender.

Because of staffing constraints, it is currently taking some VA offices an average of more than three months after title has been vested in the name of the Administrator to pay the lender's foreclosure claim. These delays in claim payments unnecessarily forestall the lender's reimbursement and cause additional losses to lenders because they must continue to advance interest to investors in GNMA securities. The VA should be staffed at a level that will enable the VA to settle lenders' claims within 30 days of the VA's acquiring title to the foreclosed property.

On the issue of the development and management of VA automated data processing systems, MBA believes that the VA should be given adequate resources to provide it with

updated technology that would allow VA staff to perform their functions more efficiently. Automation has become the way of operating mortgage companies and its effects have been widespread. For example, MBA has worked with the FHA to use automated systems to eliminate the need for lenders to telephone FHA field offices to obtain case numbers and appraisal assignments. Through the interface of MBA's electronic communication system (ECHO) and FHA's Computerized Underwriting Management System (CHUMS), lenders are able to obtain this information automatically, thereby saving valuable staff time for both lenders and FHA. Additional applications are already underway to facilitate the collection of mortgage insurance premiums and issuance of mortgage insurance certificates. If the VA had adequate computer support, similar staff savings would be possible.

One very sore issue is the disposition by the VA of properties it has acquired through foreclosures. Dumping of properties by the VA may reduce its inventory, but such activity has serious ramifications for the community. The VA has a responsibility to manage its properties in such a way that does not have an unnecessary deleterious effect on property values. By holding onto properties until the local economy turns around and renting them in the interim, the VA might very well minimize its losses while at the same time not negatively impact on a community's tax base. The feasibility of utilizing the VA's properties as rentals should be fully explored.

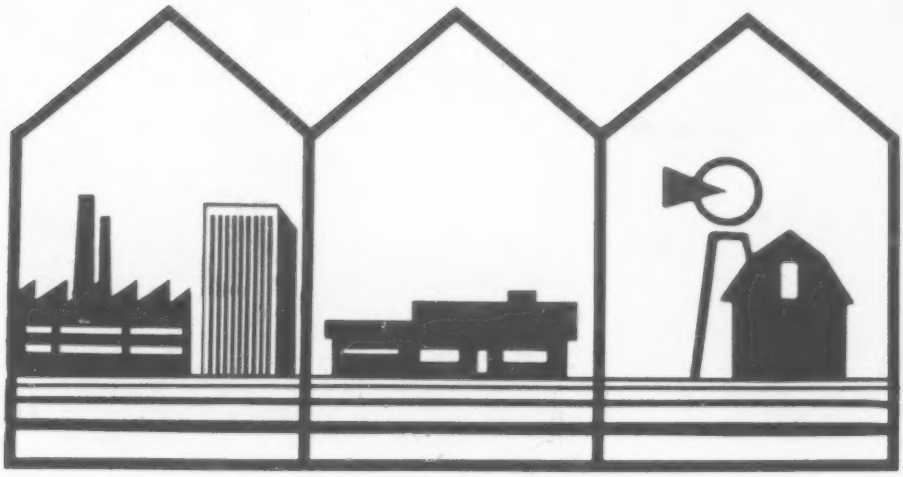
CONCLUSION

MBA would like to close with a comment on Federal credit reform as proposed by the Administration's Fiscal Year 1989 budget.

The Administration's budget proposes that under "credit reform," an appropriation will be requested for "grant equivalent subsidies" for the home loan guaranty program to recognize the "favorable financial terms" of the veterans' home loan guaranty program, compared with the terms under which borrowers obtain loans from private lenders. The budget assumes that an additional $1.3 billion in budget authority would be required in FY 1989 to reflect claimed "grant equivalent subsidy" for Federal guarantees on home loan mortgages, as well as direct vendee loans.

This proposed change to the budget process encumbers the VA home loan program with unnecessary and restrictive budgetary requirements, which MBA anticipates would not reflect the actual dollar cost of the program. MBA opposes these budgetary modifications on the ground that they overstate the costs of the program, and MBA urges the Committee to oppose proposed legislation which would require these changes.

MBA appreciates the opportunity to testify before this Committee and would be happy to answer questions or provide additional information, as necessary, for inclusion in the hearing record.



Statement of the

NATIONAL ASSOCIATION OF REALTORS®

THE WORLD'S LARGEST TRADE ASSOCIATION

TO: SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS OF THE HOUSE VETERANS' AFFAIRS COMMITTEE

ON: VA HOME LOAN GUARANTY PROGRAM

BY: BOB J. MUFFLEY, 1988 CHAIRMAN, GOVERNMENT MORTGAGE PROGRAMS SUBCOMMITTEE, REAL ESTATE FINANCE COMMITTEE

DATE: MARCH 17, 1988

STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

BY

BOB J. MUFFLEY

CHAIRMAN, GOVERNMENT MORTGAGE PROGRAMS SUBCOMMITTEE

MARCH 17, 1988

INTRODUCTION

My name is Bob J. Muffley. I am a REALTOR® from Gooding, Idaho and the 1988 Chairman of the Government Mortgage Subcommittee for the NATIONAL ASSOCIATION OF REALTORS®. On behalf of the more than 800,000 members of our Association, I want to thank you and the members of this Subcommittee for the opportunity to present our views on veterans' housing issues, and specifically, those matters affecting the VA Home Loan Guaranty Program.

The NATIONAL ASSOCIATION OF REALTORS® continues to believe in the VA Home Loan Guaranty Program and pledges its support to work with this Subcommittee to ensure that the program continues to fulfill its goals and objectives of helping veterans buy and remain in their homes. We commend the efforts of the Subcommittee during deliberation of the Veterans' Home Loan Guaranty Program Improvements and Property Rehabilitation Act of 1987, Public Law 100-198. We were pleased to work with you on this important legislation.

The NATIONAL ASSOCIATION OF REALTORS® believes that it is imperative for Congress to develop a formal National Housing Policy that provides a reasoned framework in which to address this nation's housing needs. Homeownership is a fundamental American value. It is a primary goal for Americans of all ages and a major stabilizing force in our society. Housing policy for veterans should be developed within the context of a national housing policy. We urge Congress to resist the temptation to accept piecemeal solutions to veteran housing concerns. We commend the Subcommittee for taking the initiative in supporting efforts to craft a comprehensive national housing policy and pledge our constant support in the future as the Subcommittee continues to work towards fulfillment of this goal.

As requested, we are pleased to offer our comments and views on the proposals to strengthen the VA Home Loan Guaranty Program and the Loan Guaranty Resolving Fund.

OPERATION OF THE VA HOME LOAN GUARANTY PROGRAM

The VA Home Loan Guaranty Program is an entitlement program established under the Serviceman's Readjustment Act of 1944. Congressional intent for the program was not to serve as an instrument to achieve any federal economic objective. The sole objective of the program since inception has been to assist eligible veterans to become homeowners.

The Program has helped to house 12 million veterans, having guaranteed $306 billion in loans since 1944. In recent years, however, severe local economic problems in some of the country, as well as program and administrative action, have resulted in rapidly growing inventories of foreclosed properties and the need for appropriations to support the Revolving Fund. We supported some of the actions taken by Congress last year in passing one of the most comprehensive bills to improve the home loan program since its inception. Improvements included were an increase in the loan guaranty amount, exemption from the sequestration provisions of the Deficit Reduction Act, use of state data for residual underwriting purposes, and direct review of appraisals by automatic lenders.

PROPERTY SALES AND RENTAL

A recent study by the NATIONAL ASSOCIATION OF REALTORS® has found that homeowership ranks at the top of America's list of priorities. This study also reported that a home provides owners not only with shelter, but also with psychological satisfaction, tax advantages and a way to accumulate wealth for the future.

The purpose of the VA program is to provide veterans the opportunity to become homeowners. We strongly urge that the VA make every possible effort to promote that goal. Home sales, especially of VA's acquired properties, is preferable to the rental of VA's acquired properties in economically distressed areas.

As we have previously testified before this Subcommittee, the Association has been working with VA for 3 years to develop a cooperative effort through which REALTORS® and other real estate professionals can assist in disposing of VA acquired properties.

There are three components to this disposition program: real estate professional education, real estate community/agency relations, and disposition methods. In the majority of member states, the program has been successful in educating an increased number of real estate professionals regarding the proper procedures required for selling a VA inventoried home. We had found

that many interested real estate professionals shy away from the VA's sales program simply because they are not well-informed. This cooperative effort presents an opportunity for these real estate professionals to learn the process and become involved in selling these properties.

In all cases, our members' staff and other real estate professionals have received cooperation, enthusiasm and interest from the regional VA offices. In some cases, our demonstration sites have established relationships with VA property management staff for the first time. In other areas, the program has served to improve and further existing relationships. Overall, we have found that each meeting has been successful in developing a better understanding between real estate professionals and VA property management staff. We have also found that simply initiating communication served to resolve what had been perceived to be long-standing problems between the two parties.

We have testified previously before this Committee about the success of our program in Northern California. Since that time, our program in Denver has developed to a similar level of effectiveness by providing real estate professionals with access to VA property information. Several local Boards have volunteered to place VA property in their MLS at no cost to the Agency. Denver REALTORS® feel this listing will provide an important means of disposing VA properties. Additionally, we would find it useful if property descriptions, photographs, and details such as those used for private listings were made available, this would greatly accelerate our members' showing of the property because of the time saved by the agent in not having to check out personally a property for which there is merely an address listing.

Our Houston Board of REALTORS® has been active in examining ways in which disposition of properties can be faciliated. They have developed the following recommendations based in part on a successful program employed by Fannie Mae:

1. Develop a management and listing program for members of the local Board of Realtors to include management agreements and exclusive right to sell listing agreements with MLS members, broker price opinions and Realtor rehabilitation recommendations.

1. Develop a management and listing program for members of the local Board of Realtors to include management agreements and exclusive right to sell listing agreements with MLS members, broker price opinions and Realtor rehabilitation recommendations.
2. Develop criteria for rehab work that will include three bids from approved contractors.
3. Develop a budget per house to be used to repair and maintain each property. Rehabilitation work should include new carpet, new paint, appliances and any repair and maintenance work required to put the house in a competitive marketing condition.
4. For the protection of all parties, closings of property should take place at a licensed title company and buyers should be furnished with an owners title policy paid for by VA.
5. Offer competitive financing terms that will improve the marketability of each property.
6. Provide adequate staff to review and respond to all offers of sale promptly and expedite closing procedures.

Fannie Mae's program has demonstrated that listing with REALTORS® and placing their properties in MLS has helped to reduce the number of properties in its inventory, increased the price per unit and saved substantial amounts of money by allowing REALTORS® to manage, list and sell its homes.

Local boards have effective and efficient ways of selling these properties. They are experts in the field of selling homes, and they know the local real estate market. For example, the Houston Board of REALTORS® has over 10,000 members. Through the Multiple Listing Service, properties will be available to real estate professionals who last year sold approximately 30,000 homes.

We believe that the experience and knowledge possessed by REALTORS® will allow VA to reduce the number of properties they currently have in inventory and put them on an equal footing with other sellers that are currently utilizing the services of REALTORS®. This plan also permits VA to better utilize its present staff.

We have several concerns about the effectiveness of rental programs in alleviating pressure on the LGRF. When the VA acquires a property, it makes an outlay from the LGRF equal to the market price plus the guaranty. If the VA rents the property, it will take years to compensate the fund for the cash

disbursement. If the VA sells the property, however, the LGRF is replenished immediately.

We are also concerned about the potential effects of rental programs on the local economy, and on VA's ability to dispose of the properties. The economically depressed areas for which rental programs are proposed are generally characterized by severe supply and demand imbalances for both rental and sale homes. As a result, these areas usually have very low absorption rates of the existing housing supply.

Placing VA properties in a distressed rental market would have the effect of driving down rents. This downward pressure could result in more foreclosures, as rental income declines. Correspondingly, the market value of homes for sale would decline, due to the lower costs of rental compared to buying. This could further slow the absorption rate of excess homes for sale, and delay VA's ability to dispose of its inventory.

Further, we believe that the administrative burden of a rental program would put unacceptable strain on VA staffing of local offices.

The NATIONAL ASSOCIATION OF REALTORS® believes that the most cost effective approach for handling foreclosed properties in economically distressed areas is aggressive, orderly and carefully planned disposition programs such as those we have described.

STAFFING

If we have learned anything from our visits to regional VA offices over the past 3 years, it is that the VA Home Loan Guaranty Program departments are understaffed and lack adequate resources. For example, our members and the regional VA offices has established a "computerized bulletin board," in which real estate professionals can access information regarding VA's listings.

Not only can real estate professions call up a particular VA property listing, but they can also access the status of that property. The "bulletin board" concept appears to be a workable, yet cost-effective method to increasing exposure to VA properties. However, VA does not have the manpower to assign to the endeavor. This situation is even worse for the staff and resources available specifically to the property management section of the Program.

The members of the NATIONAL ASSOCIATION OF REALTORS® are investigating every possible avenue to assist the VA in their property disposition efforts.

In Denver, for example, members have even volunteered to send college students, on a intern basis, to assist VA by answering the telephone, opening sealed bids or phoning prospective buyers that their bids were not accepted. Because the information on loan applications must be kept confidential, VA cannot accept this assistance.

The limited staff available to property management and disposition is working hard to dispose of these inventoried homes, sometimes in very creative, cost-effective ways. However, they simply need additional basic resources. Oftentimes, there aren't enough funds to even keep an information "hot line" open for the public and the real estate community.

We believe that if this or any other program to increase sales of VA inventoried properties is to work, VA must be provided with the human resources to meet it goals.

VA MORTGAGE INSURANCE PROGRAM

Our Association shares the Subcommittee's concerns about the depletion of assets in the VA Loan Guaranty Revolving Fund (LGRF) and the Fund's long-term viability. We do not believe that there is a quick fix to the problems facing the LGRF. We strongly support rigorous examination of alternative approaches to develop long-term solutions. We believe that the state of the fund is likely to benefit from action already taken by the VA to correct underwriting deficiencies — a major cause of claims against the Fund.

The Subcommittee has asked for comments on mortgage insurance versus the current one percent funding fee. We are concerned that the current solvency problems of the LGRF may be used to change the original entitlement purpose of the Home Loan Guaranty Program, with the result that veterans, often with limited cash resources, will be responsible for the funding of the program. We strongly believe that any insurance program for veterans must be funded in such a way that it does not raise the cost to the veteran beyond the current one percent funding fee.

An insurance program must be funded to cover both current and future contingency claims, as well as administrative expenses. Additionally, the insurance must be adequate to pay taxes, maintenance, sales expenses, etc. on any acquired properties and the increased administrative expenses involved. The assets of the insurance pool must be invested to help defray any future expense.

A potential model for investing pool assets is the Mutual Mortgage Insurance Fund (MMIF) which insures the FHA 203(b) single-family homes program. These assets are invested in U.S. Treasury Securities, which performs two public policy functions. First, it ensures that the funds assets are placed in a low risk investment class, and that funds will be available when needed in the future. Secondly, investing in Government securities helps the U.S. Treasury better manage the cash flow needs of the federal goverment.

It is important, however, to distinguish the MMIF from any potential VA insurance program. First, the MMIF is funded by FHA borrowers through a 3.8 percent mortgage insurance premium (MIP), a cost significantly greater than the one percent funding fee paid by veterans. Non-government estimates of the MMIF actuarial needs have indicated that the MIP fee should be in a range of 3.4 to 4.0 percent over the immediate future to cover all contingent liabilities on its "book", i.e., its insurance in effect.

Our Association would have serious concerns if a VA insurance program were not provided sufficient reserves to cover its contingent liability. As the MMIF experience suggests, the cost of an insurance program to the veteran could be substantially higher than the current one percent funding fee. Given the entitlement nature of the VA program, our Association cannot support any shift to an insurance program that is funded by veterans.

VA LOAN GUARANTY REVOLVING FUND

We share the continuing concern over the financial stability of the VA Loan Guaranty Revolving Fund (LGRF). This Fund is responsible for paying both the program's administrative costs and mortgage claims. Unfortunately, the Direct Loan Revolving Fund (DLRF), which historically transferred its earnings to the LGRF when a deficit occurred in that Fund, was terminated in 1981 (except for a small number of loans for specially adapted housing). At that time, the Administration required VA to sell the majority of its direct loans. The result was the loss to the LGRF of the steady income stream from interest on those loans.

The NATIONAL ASSOCIATION OF REALTORS® believes since the Direct Loan Program no longer has the resources to support the LGRF and given the entitlement purpose of the VA Home Loan Guaranty Program, Congress has two choices - recognize the need for continuing appropriations for the program, or reexamine the DLRF as a potential revenue source which would reduce the need for general revenues to support the program.

OTHER ISSUES

There are other actions which can be taken to reduce claims against the Fund. For example, we believe that voluntary deed conveyance can be an expeditious means of terminating a delinquent loan. This permits the veteran to voluntarily convey the property deed to VA, and in return, be released from liability to repay the government for any claim VA pays as a result of the loan termination. Voluntary deed conveyance avoids the often lengthy foreclosure process, and allows VA to acquire the property more quickly without the costs, including interest, taxes and legal expenses, that attend foreclosure.

VA generally does not accept a voluntary deed if it believes that it can collect from the veteran the amount of the claim VA pays the lender as a result of the loan termination. However, in several regional VA offices, voluntary deeds are (have been) accepted if veterans were willing to sign a promissory note to repay the claim.

The NATIONAL ASSOCIATION OF REALTORS® believes VA should determine whether it is feasible to use this practice in other offices as a means for reducing the debt of the veterans and avoiding the considerable expenses associated with foreclosures.

For the record, we offer our comments Senate Bill 2049 - "Veterans Home Loan Guaranty Program Improvements Act of 1988."

1989 BUDGET PROPOSALS

CREDIT REFORM

The Administration is again urging legislation it has dubbed "credit reform". The claim is made that this legislation would merely change the way that federal credit programs are treated in the budget.

The mortgage credit programs of the Federal Housing Administration (FHA), the Veterans Administration (VA), and the Government National Mortgage Association (GNMA) are all affected by this proposal. The proposal, as originally submitted, provides that the Secretary of Treasury estimate "subsidy" levels of credit, as well as guaranteed loan volume, to be provided by these agencies, and that the Secretary develop estimates which would determine the appropriation for these programs by Congress. In effect, this proposal would treat loan guaranty programs as direct spending programs for federal budget process purposes.

This proposal, if adopted, will have a major impact on the federal mortgage credit programs and the way they are authorized and approved. The procedural mechanisms required and the degree to which the Treasury will control the subsidy estimates will affect the availability of these programs. If borrowers, lenders, and investors are uncertain that these programs will be available at all times, this uncertainty could result in an unwillingness to use the programs. These mechanisms will pressure authorizing committees to increase user fees rather than to seek appropriations to cover the Treasury Department's determination of an estimated subsidy. Moreover, the legislation would effect a combination of definition and procedural changes that would profoundly change the decision making process for all federal credit programs.

We oppose the addition of yet another layer of budget and appropriations procedures on these programs. Gramm-Rudman-Hollings imposed the requirement that all federal credit programs be subject to credit budget limits that place a ceiling on program activity. This requirement was intended to give Congress a "handle" on the level of federal credit. The credit reform proposal contained in the 1989 budget proposal does not remove the credit budget requirement, but adds an additional procedural layer.

These changes clearly would have major impacts on veterans loan programs as well as other loan and guarantee programs. We believe there are serious questions about the proposal which should be carefully examined. While credit "reform" was passed by the Senate last year as a part of the Gramm-Rudman-Hollings amendment, it has not been subjected to full committee hearings by any committee or been reported by any committee of this Senate or the House.

We urge your Subcommittee to subject Administration's proposal to adequate scrutiny and hearings by the appropriate Committees, before taking action.

The NATIONAL ASSOCIATION OF REALTORS® appreciates the assistance you were able to provide our Association last year when credit reform was originally proposed and request that you once again join with us in our efforts to ensure that this controversial proposal be subjected to the necessary due process requirements provided for policy changes of this magnitude.

DEREGULATION OF THE VA NEGOTIATED INTEREST RATE

This proposal repeals the authority of the VA Administrator to establish the maximum rate which veterans may pay on VA-guaranteed home loans. This

statutory change would allow veterans-borrowers and lenders to negotiate the interest rate on VA-guaranteed loans.

As this Subcommittee knows, in 1983, the FHA administered rate was deregulated to allow for a rate as agreed upon by the borrower and the lender. The NATIONAL ASSOCIATION OF REALTORS® supported that modification, and believes that it significantly improved the ability of borrowers to utilize that valuable program. We similarly will not oppose legislation which would substitute the market forces of supply and demand for the artificial restriction on interest rates of VA-guaranteed loans.

The rapid increase in mortgage rates which occurred in March and April 1986 illustrates the need to allow competitive forces to determine the interest rate on VA loans. Although VA attempts to establish a rate which reflects the current market, the administered VA rate does not keep pace with market forces, particularly when mortgage rates rise rapidly or where the market is volatile.

We believe a negotiated rate on VA-guaranteed loans is an important step in keeping the VA Home Loan Guaranty Program responsive to the changing economic and financial needs of all veterans.

THE COMMISSION

The NATIONAL ASSOCIATION OF REALTORS® would gladly participate in the Senate bill's proposed Independent Commission on the VA Home Loan Guaranty Program. The Commission would make recommendations in several areas, including ways to reduce loan defaults and foreclosures rates; ways to minimize VA property acquisition, management, and disposition costs; ways to improve the solvency of the VA loan guaranty revolving fund; and the need for improvement in veterans' programs benefits and assistant.

The Association believes that however Congress chooses to approach examining the restoration of the solvency of the LGRF is not the issue. Whether the investigation is conducted by a Commission or another Congressional body, the goal is to keep the VA program's original purpose as an entitlement program to permit veterans who do not have the cash resources or an established credit history to purchase a home at the forefront of its agenda, before seeking program improvements. Provided the interest of veterans is adequately protected, we believe that an Independant Commission could help to investigate and recommend solutions to the financial problems of the program.

INTEREST RATE ON VENDEE LOANS

The Association recognizes that the VA frequently competes with homeowners in economically distressed areas who may be offering below market rate seller-financing to attract buyers for their properties. We are concerned, however, about the cost to VA for subsidizing these below market rate loans. The bill does not address how this cost would be estimated or how the subsidy would be funded.

Although we support efforts to expedite the disposition of VA's inventory, we urge the committee to investigate and evaluate the costs of offering below market rate financing to determine whether it is justifiable when compared to minimum cost alternatives such as aggressive property disposition programs.

ASSUMPTION OF VENDEE LOANS

It is widely acknowledged that assumability has been instrumental in increasing the marketability of VA inventoried properties. In today's market where most fixed rate conventional mortgages contain "due-on-sale" clauses, the FHA and VA programs are one of the last bastions of fixed payment mortgage instruments which allow assumability.

Especially during periods of rising interest rates, the free assumability of mortgages has often substantially enhanced the value of a home. The buyer benefits because he or she can assume a loan below the prevailing market rate. This assumability also translates into a benefit for the seller by increasing the demand and thus, value for his/her home.

This change in the assumability of VA mortgages could also have a long-term, negative impact on the VA Loan Guaranty Revolving Fund. By requiring new underwriting guidelines, it is likely that potential homebuyers who, at one time, would be willing to take over the monthly mortgage payments from a financially distressed seller, will no longer be amenable to assuming the VA-financed mortgage because of the additional cost and the time imposed by the new requirement. As a result, financially-strapped homeowners with the VA-financed mortgage will have a few alternatives but to default on their VA mortgage.

The NATIONAL ASSOCIATION OF REALTORS® continues to believe that the veteran and the purchaser should be made jointly liable for the loan as an alternative to obtaining a credit check. The VA or approved lender would be required to explain this alternative to the veteran before a credit check

could be instituted, and the veteran would have to certify that he or she was so advised. Utilizing this alternative procedure, a creditworthiness check is not required. Additionally, under this arrangement, liability for the loan will transfer automatically to the purchaser provided the loan is not in foreclosure after five years.

CONCLUSION

Once again, we appreciate the opportunity to present our views on veteran's housing issues, and those matters affecting the VA Home Loan Guaranty Program. I will be happy to answer any questions.

2237r

Statement of

James J. Butera
Group Vice President
for Legislative and Regulatory Affairs

of the

National Council of Savings Institutions

before the

Subcommittee on Housing and Memorial Affairs
Committee on Veterans' Affairs
United States House of Representatives

Oversight Hearing on

The VA Home Loan Guaranty Program

March 17, 1988

Madam Chairwoman, I would like to thank you for the opportunity to present the views of the National Council of Savings Institutions on the Veterans' Administration (VA) home loan guaranty program. The National Council of Savings Institutions is a trade association representing savings banks and savings and loan associations nationwide.

The VA loan program has been an extremely successful program since its inception in 1934. It has facilitated home purchases for over 12 million veterans. A review of the VA program is very timely in light of increasing losses associated with changing market conditions. Clearly a reexamination of loan underwriting policies, fee structure, and disposition of foreclosed properties are well warranted in today's non-inflationary environment.

Going into this hearing, we must keep in mind that the features of the VA loan guaranty program that make it the most valuable to the veteran, also make it the most risky and expensive for the government. It will be the job of this committee to balance the needs of the veteran with the budget realities of today.

VA Losses Due in Part to Disinflation

The vast majority of real estate losses today stem from the abatement of inflation that drove real estate prices up consistently through the late 70's and early 80's. Deflationary trends appeared in many parts of the country and were most significant in regions with dominant industries suffering severe problems, such as the oil belt and agricultural regions.

During the highly inflationary 70's and early 80's the escalating values of real estate covered up many of the risks associated with lending on properties with little or no money down. If borrowers could not meet monthly payments, properties could be sold profitably and loans paid off without the need of going through foreclosure. Borrowers would struggle to pay mortgages representing a higher and

higher percentage of monthly income, because the investment return on the property was so great.

In deflationary times, however, if a borrower could not meet payments, the ability to sell the property and recover losses evaporated. Exacerbating problems were borrowers who could make payments but exercised their option to walk away from a property. This often happened when a homeowner saw a neighbor's house selling for less than the outstanding principal balance on his own house, so the sacrifice of making monthly payments appeared to be too great.

The abatement of inflation has caused tremendous upheaval in the real estate finance industry. With consistent inflation, as we experienced in the latter half of the 70's and early 80's, problem loans were propped up by inflation, so lenders, mortgage insurers, and investors approached the market in high gear with a "volume equals profits" mentality. In a market with values increasing ten percent annually, for example, a high loan-to-value loan would quickly develop a buffer of inflation-created equity to provide a safer loan.

The VA loan program is not the only major mortgage program losing money these days. The private mortgage insurance industry has also experienced large losses over the past few years. I would like to attach at this point two recent articles outlining the current status of the mortgage insurance industry (Exhibits A and B).

No Downpayment Equals High Risk

The relationship between risk and homeowner equity in a home is clear. The less equity, the greater risk. In an actuarially sound insurance program, the cost for insurance goes up with risk. The risk is outlined very well in the following passage taken from a major study on the mortgage insurance industry done by Moody's Investors Service in March of 1985. This precisely pinpoints the phenomenon of risk and high loan-to-values.

Loan-to-value has been a particularly sensitive measure of relative risk, since it delineates the degree to which the borrower has a stake in the property, especially in the early years of the loan. The higher the down payments, the less is the likelihood that the borrower will walk away from the loan. In order to examine the relative risk of loans by original loan-to-value and to compare the experience of firms over time and under various economic situations, Moody's requested and received claims/survivorship data by loan type, loan-to-value, and year of origination for seven firms in the industry. These seven firms currently account for 90% of private mortgage insurance in force.

Based on ever-to-date claim rates for combined data sets, the graph reflects the general experience of the MI industry on more than 4 million loans classified by loan-to-value. Based on data on all loans originated by these seven firms from 1957 to 1983, loans with 5% to 9% down (91%-95% LTV) were 1.69 times as risky as loans with 10% to 14% down (86%-90% LTV), and 3.25 times as risky as loans with 15% to 19% down (81%-85% LTV).

Exhibit C is a chart taken from that study which illustrates this point.

The response of the mortgage insurance industry has been prudent, but it has changed the availability and cost of certain mortgages that flourished in inflationary times. Very high loan-to-value loans are often unavailable at any cost, and other loans have tougher underwriting standards and higher fees.

The VA can certainly make changes to its program to reduce costs to the government, but this may remove some of the most valuable features of the program. The most important feature is the no money down, 100% financing. Approximately 66% of VA loans are originated with no buyer

equity in the property. Since the 1% fee may also be financed, you have, in many instances, 101% loans made in which in the mortgage amount is actually higher than the purchase price of t ? home.

Either the 1% fee must be increased (across the board or for the riskier loans), and/or downpayments must be required if the cost of the VA program is to be addressed. However, since the VA program has traditionally been an entitlement benefit program for veterans, the Congress may well decide that this is a cost well worth bearing. The Council does not have a formal position on this question, but is rather providing the Subcommittee with information with which to assess the situation.

Disposition of Foreclosed Properties

Finally, I would like to address a question you raised in your invitation to testify and that is the disposition of VA foreclosed properties in distressed regions. As you know the economic conditions in certain areas of the country, most notably Texas and other parts of the southwest, have wreaked havoc on local economies, and have driven major real estate markets into virtual collapse. As a result of these conditions, lenders in impacted regions have tremendous numbers of foreclosed properties, known as REO (real estate owned) on their books. These properties may become deteriorating, salvageable assets for financial institutions and others involved in real estate finance.

The correct handling of troubled real estate markets is critical in assuring that the situation is improved and not exacerbated. If REO is dumped or sold at extremely low prices to remove it from the carrying institution's books, a spiral of deflating values and increasing foreclosures can result. For instance, as properties are dumped in an area, the salvage value of other REO is harmed. Furthermore, mortgagors who can afford to continue to meet their payments will see similar properties to the one they own being sold for less than the outstanding principal balance on their own loans. In these cases borrowers have been known to exercise their implicit

option to walk away from the property. Therefore, the injudicious handling of REO can lead to more and more foreclosures.

I would like to include with my statement a recent article in the Washington Post on the disposition of REO in Texas by the VA and other government related mortgage agencies (Exhibit D).

Our concern is that if the VA sells properties at prices that are too low in order to get them off their books, the taxpayer is ill served, and other lenders holding properties through foreclosures are also hurt. As we have a national mortgage market, lenders throughout the nation are affected by poor real estate markets in certain distressed regions.

Since these VA sales of REO are financed with no money down, we would suggest that, in effect, these buyers are renting. We would suggest that the VA look seriously at the option of renting the properties to sell them later when prices rise. This will benefit the VA program in the long run.

Madam Chairwoman, I would like to thank you for the opportunity to have testified before you today, and I stand ready to answer any questions you may have.

Exhibit A

Business Week
3/7/88 Pg. 104

Finance

INSURANCE

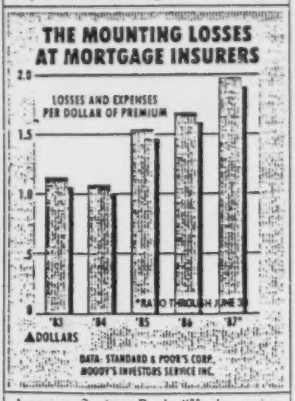
A CRUCIAL LINK IN THE HOUSING CHAIN CRACKS

Downpayments may soar as mortgage insurers crumble

When the inflation of the 1970s boosted home prices out of sight, many would-be buyers could no longer come up with the traditional 20% downpayment. Enter private mortgage insurers. If a buyer put down only 5%, the lender would make him buy private insurance on 15% of the value. Thus, if the homeowner defaulted, the lender still had that 20% cushion. Everyone was happy—for a while.

Now, because of the delay, paperwork, and extra costs involved, "most people don't want the hassle of private mortgage insurance and, if at all possible, scrape up the 20%," says Mary Pape, assistant manager of New York's American Savings Bank. "You're seeing a real swing toward mortgages with 20% down," agrees Roger Powell, a thrift analyst with Alex. Brown & Co.

What happened? As inflation ebbed, prices became erratic and, particularly in the Southwest, many people walked away from their homes. Rising delinquency and foreclosure rates began inflicting grave losses on insurers (chart). In the last four years they have shelled out about $2 billion in claims. So they're raising rates and pulling in their horns. New premiums have fallen to about one-fourth of the 1985 peak of $1 billion.



The biggest casualty has been TMIC Insurance Co. (table), which was dragged down by its involvement with Equity Programs Investment Corp. Through the 1970s and the early 1980s, EPIC developed and built about 22,000 homes, many in depressed areas of the Southwest. But EPIC also was uniquely susceptible to disinflation because its properties were heavily mortgaged. Some $1.4 billion of EPIC mortgages were sold to investors, and about half were guaranteed by TMIC. In 1985, EPIC defaulted on its loans, and TMIC and other insurers backing EPIC paper had to pay up. TMIC's capital eroded, and on Feb. 22 the California state insurance commission petitioned a court to begin liquidating TMIC.

PLAYING HARDBALL. But the industry's woes go beyond EPIC. With losses flowing, insurers are seeking reasons to deny claims, and friction between them and policyholders is building. The Oklahoma Housing Finance Agency recently went to court to challenge Verex Assurance Inc. The agency holds about $585 million in mortgages, of which Verex insures about $280 million worth. With about 10% of the mortgages delinquent, Verex is at risk for some $28 million, estimates Tim Martin, the agency's comptroller. But, he says, Verex is balking at many of the claims, insisting that lenders got the insurance fraudulently.

Verex lost $20 million in the first half of last year, and in January its parent, Greyhound Corp., decided to quit the business. Greyhound, which pledged to support existing policyholders, wouldn't comment on the Oklahoma court action. Meanwhile, the National Council of State Housing Agencies, a trade group, is canvasing its members to see if others have problems with Verex. "The insurers have as much responsibility in the underwriting process as the lenders," asserts David B. Pinson, the council's director of program and policy development. "But these guys are playing hardball with the claims."

Mortgage Guaranty Insurance Corp. faces even bigger potential losses in Alaska. MGIC partially backs $1.4 billion worth of the $4 billion in mortgages held by the state's housing finance arm, 20% of which are delinquent or foreclosed. Even with 80% of its risk there reinsured, MGIC President William Lacy acknowledges that the experience "has been disappointing. The industry is going through heavy losses."

A clear signal of the industry's overall liability may emerge soon from EPIC-related cases in Alexandria, Va., where two insurers are suing to rescind the insurance they issued for EPIC mortgages. Like Verex, they claim they were defrauded by EPIC and thus owe nothing to the holders of EPIC mortgages. "The entire industry, like other insurers, relies on what the applicant tells them," says Jim Williams, attorney for United Guaranty Residential Insurance Co. "If you have to send in a team of accountants to check every policy, private mortgage insurance wouldn't be available."

STUNG. Warren Dennis, an attorney representing the trustee for EPIC mortgages, says the insurers are liable. "It's unfortunate," he says, that the companies "have gotten in the practice of suing their customers. It undermines the validity of all of their guarantees." EPIC denies the fraud charges.

HOW THE LARGEST COMPANIES STAND

	Coverage* Billions	Capital* Millions
WISCONSIN MORTGAGE ASSURANCE**	$14.5	$405
VEREX**	7.2	275
UNITED GUARANTY RESIDENTIAL	5.3	241
GENERAL ELECTRIC MORTGAGE (Ohio)	5.1	257
PMI MORTGAGE	4.6	229
MGIC	4.2	311
TMIC**	3.7	–111
GENERAL ELECTRIC MORTGAGE (Calif., Fla., N.C.)	1.7	131

*As of mid-1987
**No longer writes new policies
DATA: MOODY'S INVESTORS SERVICE INC.

Stung, insurers are cleaning up their act. They are stiffening the requirements for buyers who put down only 5% and are rejecting more applicants. Well-capitalized players such as MGIC and GE Mortgage Insurance Cos. keep paying without reported complaints from policyholders. They maintain that they are in business for the long haul and that the industry should be profitable in a few years. Unfortunately, as the industry becomes more prudent, mortgage insurance may be available mostly to borrowers who can afford to do without it.

By David Zigas in New York

Exhibit B

New York Times
3/3/88 B. D1

Upheaval at Mortgage Insurers

Industry Was Slow To Adapt to Changes

By ERIC N. BERG

The private mortgage insurance business, which for decades has been a virtual money machine, is now running up losses at an alarming rate.

Last month's collapse of the TMIC Insurance Company, a large private mortgage insurer, may have provided an extreme illustration of the impact of the losses.

But industry experts say most other private mortgage insurers are also in the red or retreating from the market. That could have a big impact on prospective homeowners, especially young first-time buyers, who can only afford a down payment of 10 percent or less. Many lenders will not do business with such people without insurance, which typically covers 25 percent of the mortgage.

"For the private insurers, the question is to what extent can they continue to serve a borrower who has little or no down payment, little or no savings and is thin financially," said Roger F. Blood of Temple, Barker & Sloane, a consulting firm that has studied the private mortgage insurance industry.

Rising Housing Prices a Cushion

Until the early 1980's, private mortgage insurers had flourished. Even when buyers defaulted on their mortgage payments, insurers were rarely stuck because steadily rising housing prices meant that the homes could usually be sold at a profit.

But in recent years, thousands of people have defaulted on their mortgages in the economically troubled Southwest and the Farm Belt, where housing prices have plummeted. Moreover, insurers were not choosy enough in the mortgages they guaranteed in these regions and elsewhere in the country — a practice that is now coming back to haunt them, industry officials concede.

In the early 1980's "almost anybody could get insurance at a very low price," said J. Allan McNichol, chairman and chief executive of the PMI Mortgage Insurance Company, a unit of Sears, Roebuck & Company.

Michael A. Carpenter, an executive vice president of the General Electric Capital Corporation, the parent of the General Electric Mortgage Insurance Companies, added: "What was a riskless business became a risky business. There were some companies that didn't understand the changes until it was too late."

The result has been a huge run-up in payouts by insurers and a retrenchment in the industry.

For instance, the third-largest insurer, United Guaranty Corporation, a subsidiary of the American International Group, has suffered underwriting losses for a number of years and has stopped writing policies in eco-

Continued on Page D5

(more)

Biggest Private Mortgage Insurers

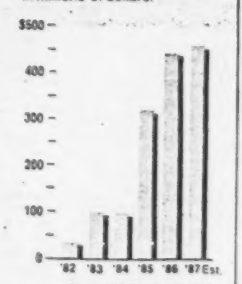
Ranked by companies with the largest current coverage.

Company	Amount in billions
Verex Assurance	$7.2
General Electric Mortgage Insurance (Ohio)	5.6
United Guaranty Residential Insurance	5.3
PMI Mortgage Insurance	4.6
Mortgage Guaranty Insurance	4.5
General Electric Mortgage Insurance (North Carolina)	1.8
Commonwealth Mortgage Assurance	1.7
Republic Mortgage Insurance	1.2
Foremost Guaranty	1.2
Home Guaranty Insurance	0.3

Source: Standard & Poor's

Soaring Losses

Underwriting pretax losses, in millions of dollars.



Source: Mortgage Insurance Companies of America

Upheaval at Mortgage Insurers

Continued From First Business Page

nomically depressed parts of the country, according to Maurice Greenberg, A.I.G.'s president and chief executive. PMI, No. 4 in the industry, is also unprofitable and has ceased writing policies in Louisiana and Oklahoma.

Other industry heavyweights — including the Wisconsin Mortgage Insurance Company, which was formed from the old MGIC Insurance Company, and Verex Assurance Inc., a subsidiary of the Greyhound Corporation — have withdrawn or plan to withdraw from the business entirely.

Continued High Losses Expected

"We anticipate a continued high level of losses," said Steven P. Doehler, executive vice president of the Mortgage Insurance Companies of America, the industry trade group.

The retrenchment could have even more serious implications for prospective homeowners if an attempt in Congress to reduce the role of two Federal agencies in the business succeeds. The two agencies — the Federal Housing Administration and the Veterans Administration — back roughly 60 percent of all insured home loans, with private insurers behind the remaining 40 percent.

Private mortgage insurance began in the early part of this century, before the F.H.A./V.A. loan programs were created.

In a system that has remained essentially unchanged over the years, mortgage insurance is typically purchased by a savings and loan association, bank or other home lender when the down payment on a loan is 10 percent or less. If a homeowner, who is responsible for paying the insurance premium, defaults, the lender files a claim with the mortgage insurer. The insurer then has a choice: either it can pay the policy amount or it can pay off the loan, take title to the house and try to sell the property.

This relatively straightforward business was, for much of this century, a sure bet. "The mentality was, 'You're providing insurance, but you never lose money,' " Mr. Carpenter of G.E. said.

Mr. Greenberg of A.I.G. added: "The industry did well during an inflationary period. Inflation bailed out real estate values."

Environment Changes Markedly

In the early 1980's, however, the environment in which private mortgage insurers operated began to change profoundly.

First, sky-high interest rates spawned a whole new category of risky home mortgages — including loans with low initial interest rates that then rose sharply and graduated-payment loans in which the monthly payments rose over time. In retrospect, mortgage insurers should never have guaranteed such loans, many of which have since gone into default.

Next, came the collapse of farm prices, which ate into the value of homes in the Farm Belt. Beginning in late 1982, large numbers of private insurers found themselves making payouts on their policies for the first time in years.

Then, in the last two years, the drop in oil prices began causing widespread mortgage defaults in the Southwest. The collapse of TMIC, better known as Ticor Mortgage, its former name, largely stemmed from the concentration of its policies in Texas and nearby areas.

Industry Losses Soar

But TMIC was not alone in having problems. Almost the entire industry either failed to respond to the changes or reacted too slowly, industry executives now concede. Insurance losses began to soar — to an estimated $460 million last year from $36.1 million in 1982.

The fact that mortgage insurance

> The industry prospered because real estate inflation bailed it out.

premiums had been held down by state insurance commissioners who remembered the insurers' good times did not help much. "Nobody understood that the risk of mortgage insurance was changing," said Mr. Doehler, the industry trade group head.

Some mortgage professionals believe that the industry's basic underpinnings must be changed.

Stephen A. Ludsin, for instance, a New York investment adviser who, while at Salomon Brothers, helped create the market for mortgage-backed securities, sees a fundamental conflict in the industry's relationship with lenders.

Banks and savings and loan associations, he says, do not always do the strict credit analysis they should because they know they are insured. But the insurers, he adds, rely heavily on the lender to do the analysis. The result, he says, is that too many bad mortgage loans are made that are insured.

"It's a problem," Mr. Ludsin said. "What you have is people taking on risk without each doing his own homework."

There has recently been some good news for the industry. Mortgage foreclosures and delinquencies have recently begun to decline, and mortgage insurance premiums have increased by a third over the last two years, to roughly $320 a year on a $100,000 loan, from $250.

Mr. Greenberg of A.I.G., meanwhile, is proposing the creation of an industrywide advisory council that would try to produce more sensible pricing, while others are proposing to make banks and savings and loan associations more accountable for their loans by having deductibles on mortgage policies.

But the industry's woes will not disappear any time soon. The mortgage industry has itself consolidated, with fewer, bigger lenders wielding more clout. Some industry experts warn that these lenders could have the power to pressure insurers to keep premiums low.

Need May Come Into Question

"Some larger lenders may even ask themselves if they need mortgage insurance," said James F. Schmidbauer, a senior analyst at Moody's Investors Service. By issuing mortgages in many regions, large lenders effectively reduce their relative exposure in any one region of the country and thus may feel less need for insurance, he explained.

Finally, there is the impact that the collapse of TMIC will have on the industry. Already, other insurers say they are facing a new skepticism from policyholders, who want to know if they, too, are in trouble.

The almost-certain result, industry experts say, will be continuing upheaval. Stronger players will grow even stronger and the weaker players will have to scramble to retain business, they predict.

"The whole industry is distilling into a group of companies that in turn have large parents," Mr. McNichol of PMI said.

(Cont)
New York Times
3/3/88 Bus. Dy

Exhibit C

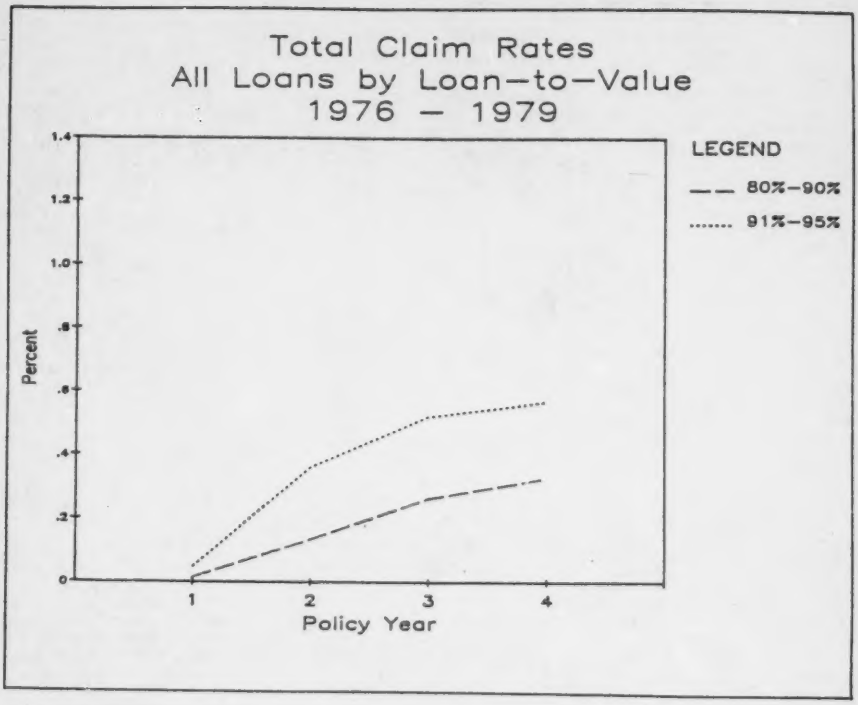

Total Claim Rates
All Loans by Loan-to-Value
1976 - 1979
LEGEND
80%-90%
91%-95%
Percent
1.4
1.2
1.0
.8
.6
.4
.2
0
1
2
3
4
Policy Year

Exhibit D Washington Post Dec. 27, 1987 Page K1

Texas-Size Recession Makes U.S. a Landlord

Oil Troubles Caused Real Estate Boom to Go Bust

By Kathleen Day
Washington Post Staff Writer

DALLAS—Imagine trying to sell all the residential property in Arlington and Alexandria—roughly 100,000 houses, apartments and condominiums—all at once during a recession.

That's the size of the task facing real estate sellers in Houston, where nearly 200,000 homes are vacant, about twice the average for most cities of comparable size.

The sudden appearance of an extra 100,000 homes in three years results from record foreclosures in the wake of fallen energy prices and a Texas-size building spree that turned sour.

The stockpile of repossessed property here has grown so big it has created a chain reaction, fueling the recession that bred most of the vacancies in the first place.

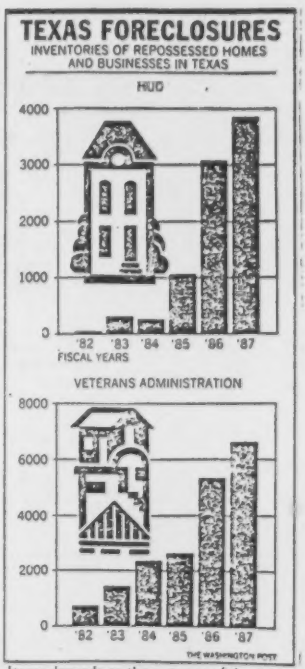
The cycle is being played out in many other areas of the country, from Denver to Peoria to Miami. But nowhere is the problem more acute than in Dallas, Houston, Austin, San Antonio and other Texas cities. They are burdened with the biggest real estate glut since the Depression of 1929. Texas homes that sold for $48 a square foot three years ago now go for $25 a square foot.

"It's very serious, very severe and unlike anything I've seen in my 25 years in the housing finance industry," said Michael A. Smilow, a vice president of the Federal National Mortgage Association—Fannie Mae—a government-chartered, privately run company that buys home loans and sells securities.

No one disputes the severity of the problem. No one disputes that an economic upswing is the long-term remedy, even though predictions of recovery rise and fall with oil prices.

What is disputed—hotly disputed—is how the U.S. government should sell the growing surplus of property it has inherited from debtors and from failed banks and savings and loans. The list includes hundreds of thousands of repossessed homes, condominiums, shopping centers and business complexes—no one knows the exact number because no one in government has added them up.

The harder the government pushes to dispose of this inventory, the lower the prices will go and the less the original lenders will recover. Investors from around the country who poured money into the state during its go-go years in the early and mid-1980s are watching anxiously, knowing the size of their losses depends on the outcome of the debate and its effect on the Texas economy.



"There's a dumping problem—there's all that property. You can't sell it all at the same time. If you do, the price gets close to zero," said Jay Janis, a California S&L executive and former chairman of the Federal Home Loan Bank Board, the federal agency that regulates S&Ls.

Said Sandra Flanigan, vice president and bank analyst at PaineWebber Inc. in Houston, "You cannot say it's just a Texas problem. Texas is not an isolated market. We're talking global markets. It's something that needs to be more directly addressed by Washington than it has been."

See TEXAS, K5, Col. 1

TEXAS, From K1

She added, "We don't think the real estate markets have bottomed. The question is, what does one do? The market's not strong enough to withstand a dumping."

Record foreclosures have turned half a dozen federal agencies into landlords, each with a separate, sometimes conflicting, policy for selling off or renting tens of thousands of properties. A joke in Houston has it that the Federal Home Loan Bank Board ought to vote on the city council because the agency has become the city's biggest landlord.

Scores of S&Ls, banks and mortgage lenders across the country also have become landlords. To them, the government's policy—or lack of policy—is no joke. They claim the sales strategy of the government is an uncoordinated free-for-all that is destroying real estate prices and undermining the efforts of private companies to dig themselves out.

William Isaac, a banking lawyer and former chairman of the Federal Deposit Insurance Corp., the federal agency that insures deposits at banks, warns that "banks around the country are going to end up paying for those problems if they're not handled properly."

Stuart A. McFarland, chief executive of SKL Holdings Corp. in Falls Church, couldn't agree more. SKL is the company that emerged when a tax shelter company called Equity Programs Investment Corp. was reorganized in 1985 under Chapter 11 of the U.S. bankruptcy code. It owns 17,000 repossessed homes, about 9,000 in Texas, and claims to be the largest manager of foreclosed properties in the United States.

"There will be a time as this death spiral continues that local municipalities will have trouble providing basic services as their tax base erodes," he said, explaining that as home values fall, so does the tax cities collect on them. That perpetuates the creation of what he calls "neutron bomb neighborhoods," or modern-day ghost towns.

"The whole problem should be privatized because the government has no idea how to manage property, how to stabilize property or how to sell to tenants so sales are paced out over time," he said.

Several Washington area institutions are creditors of SKL and stand to be big winners or losers, depending on how Texas home prices move. Among them are Dominion Federal Savings and Loan in McLean, Washington Federal Savings & Loan in D.C. and Baltimore Federal Financial.

(cont.)

Washington Post Texas-cont.

So much new foreclosed property is coming to these institutions that they hope to keep SKL alive as a jointly owned subsidiary after the bankruptcy plan is complete and earn a profit managing troubled real estate for themselves and others.

But that depends on the success of SKL, which in turn hangs on how far government policy pushes down prices.

"Our government system by its nature works against itself in trying to solve problems of this size because each agency in effect is its own little fiefdom," said Joseph E. Robert, who owns one of the largest companies in the country that manages troubled real estate.

Executives at some of the half dozen other major companies that specialize in managing foreclosed property insist they could do a better job than the government. But they say that even if the government turned over to them all the business they could manage, the federal agencies still would be left with more property than they can handle under current policy.

"The size of the problem dwarfs the amount of expertise available in this country to handle it," Robert said.

The sentiment reflects conflicting goals of the private sector and the government. Companies want to hold properties and dispose of them slowly to keep prices as high as possible. The government, in theory, also wants to sell at top dollar, but it also wants as much cash as it can get today and isn't keen to hold property on the chance it might fetch a higher price tomorrow.

With each of a half dozen agencies operating on its own, the take-the-cash philosophy ends up looking like a fire sale to private investors. Government officials insist they must operate in the interest of the government and by the rules Congress sets for them, including an assumption that the government has no business holding property on the gamble that prices might rise.

But the uncoordinated actions of the half-dozen federal agencies involved adds to the turmoil, investors say. The Federal Housing Administration, an agency that guarantees loans and takes over homes when buyers default, held 35 auctions for homes in Texas this year, FHA officials in Texas say.

That was news to FHA officials in Washington, who last week said they did not know how many auctions their field officers were holding. "As far as auctions go, they can do what they want; they can hold them when they want, it's their own thing," said Bill Glavin, an FHA spokesman in D.C. said.

Fannie Mae held 20 auctions of its own, while the bank board held six.

None of the auctions was coordinated.

Policies have become so confusing that agencies sometimes act one way one day, another the next.

For example, the Office of Mangement and Budget—which sets budget policy for the White House—in recent years ordered the Veterans Administration to sell its repossessed homes as quickly as possible to help reduce the federal deficit. But OMB in recent months came under pressure from House Speaker Jim Wright (D-Tex.) and Rep. Jack Brooks (D-Tex.), and ordered the VA to cut auctions because of complaints the agency was depressing real estate prices and hurting private companies in the lawmakers' home state.

"So we held no auctions in Texas from October of 1986 to June 1987," said Tom Maher, assistant director of property management at the VA. In the meantime, the FHA, Fannie Mae and other government-affiliated organizations were holding auctions as often as once a week, he said.

"We looked like dummies," Maher said. "We're willing to be part of a coordinated strategy [among the agencies]. But we don't want to be standing in the corner while everyone else is out playing."

The policy of the Federal Deposit Insurance Corp. is to sell its properties, mostly commercial real estate, as quickly as possible. "You have to let the marketplace take its course, even if it looks gruesome," said Steven Seelig, assistant director for FDIC liquidations. "If you hold stuff off the market, the market still knows it's there" and will adjust prices accordingly.

"You can't fool people that way," Seelig said.

Yet another agency, the bank board, is working to come up with a policy by Jan. 1 for selling property in Texas or other depressed regions. In the meantime, sometimes the agency sells property right away, sometimes it holds it, and no one is ever sure which way it will go on any particular parcel.

Real estate experts say Washington has taken much too long to focus the debate away from the cause and onto the pressing problem of what the government will do about the resulting glut of housing that by some estimates will take 10 years to unload.

The government's cache of foreclosed and repossessed real estate has doubled nationwide since 1981,

See TEXAS, K10, Col. 1

TEXAS, From K5

according to available figures, but in Texas during the same period it increased at least tenfold. By some estimates, the U.S. government and a dozen or so private companies now own about 25 percent of the housing stock in some Texas markets.

The government's failure to see the problem and address it early attests to the inability of individual agencies to comprehend the big picture, critics say.

"1986 was the year of great awakening in Washington," said Barton Smith, head of the economics department at the University of Houston. But the crisis began at least four years earlier.

OMB officials, who would not comment publicly, conceded there has been no effort to get the various U.S. agencies or federally chartered companies to coordinate efforts.

Officials at the federal agencies said they would oppose any new agency to handle the government's mounting real estate, but agreed that coordinating policy—and auctions and sales practices—might work.

"There's no easy answer," said Jay Janus. "But it's very important to have a coordinated policy so that one agency isn't selling at one price and another is selling at another price. That creates market instability."

One possible remedy discussed by the private sector would be to sell the government's repossessed real estate to the private sector as quickly as possible while allowing the government to keep rights to profits should the private company sell the property for a larger-than-expected sum.

Whatever is done or not done, one trend is certain, officials in government and business say. As the number of homes for sale rises, the price of homes will fall. The farther prices fall, the more worthless loans backed by the homes become. As loans lose value, so do the banks and other lenders holding them. The weaker the lenders become, the greater the likelihood that more real estate will fall to federal agencies.

It's a classic vicious cycle. "You can compare it to a nuclear explosion," said Joe Robert. "There aren't enough doctors to handle the medical casualties."

STATEMENT OF
THE MANUFACTURED HOUSING INSTITUTE
BY
JERRY C. CONNORS
BEFORE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON VETERANS' AFFAIRS
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
THE HONORABLE MARCY KAPTUR, CHAIRWOMAN

OVERSIGHT HEARING
THE SOLVENCY OF THE VETERANS ADMINISTRATION
HOME LOAN GUARANTY PROGRAM

MARCH 17, 1988

MANUFACTURED HOUSING INSTITUTE
JERRY C. CONNORS, PRESIDENT
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(703) 979-6620

The Manufactured Housing Institute

The Manufactured Housing Institute (MHI) is a national trade association representing manufactured home builders and related suppliers of goods and services to the industry and its consumers. Of the top 25 producers of manufactured homes in 1986, 18 were members of MHI. MHI manufacturer members produce over 60 percent of manufactured homes built in the United States.

The Manufactured Housing Industry

The advantages of mass production spawned the development of factory-built housing over 50 years ago. Today there are several forms of factory-built homes, including modular, panelized, and manufactured homes. Our remarks concern themselves with the form of factory-built housing known as manufactured homes, formerly known as mobile homes. Manufactured homes are delivered from the factory in one or more sections. They are completely assembled and require only minimal labor to make them ready for occupancy once delivered to a home site. Manufactured homes are built to federal standards prescribed by Congress in the National Manufactured Home Construction and Safety Standards Act of 1974 (P.L. 93-383). These standards were developed and implemented by the Department of Housing and Urban Development (HUD) in June 1976. As a result of HUD's involvement, these homes are commonly referred to as HUD code homes. Since developing the standards, HUD has maintained its surveillance of the manufactured housing industry primarily through its agent, the National Conference of States on Building Codes and Standards. Innovative technology, improved aesthetics, and a federal construction code that ensures consistent health and safety standards throughout the U.S. have all played a significant role in making manufactured housing an important part of the permanent housing stock in America.

Since the beginning of the decade through the end of 1987, manufactured home builders have produced 2.1 million homes, accounting for 14.5 percent of the 14.1 million privately-owned housing construction started during the decade. The 1983 Annual Housing Survey, the most recent of the annual housing surveys published by the Department of Commerce, indicates that there were 88.6 million full-time occupied housing units at the end of 1983, including manufactured homes. Full-time occupied manufactured homes accounted for 4.0 million, or 4.5 percent of the total occupied housing stock in the U.S. at the end of 1983.

The Veterans Administration Manufactured Home Loan Program

The Veterans Administration (VA) was first authorized to guarantee loans on manufactured homes by the Veterans' Housing Act of 1970 (P.L. 91-506). The 1970 Act provided for termination of the program on July 1, 1975 to give Congress time to evaluate this new program. The program became permanent with the passage of the Veterans' Housing Act of 1974 (P.L. 93-569), and Congress affirmed its belief that the VA Manufactured Home Loan Guaranty Program was beneficial and provided a good source of housing to veterans. The program has provided an estimated 110,000 veterans the opportunity to own their own home since its inception through the end of fiscal year 1987. For this reason, we believe that the program is an important and valuable part of the overall benefits provided to veterans through the various activities carried out by the VA. Manufactured home loans guaranteed by

the VA are eligible for pooling into Government National Mortgage Association (GNMA) mortgage-backed securities. So, the VA program also provides an important access to loan funds available through institutional investors and others who buy GNMA securities. Access to investors through secondary markets has become an increasingly important source of funds for housing finance in the 1980's. And, GNMA, at this time, is the only organized secondary market source for manufactured home personal property loans.

Mortgage Insurance Versus Funding Fee

The subcommittee has indicated its wish to explore the benefits of mortgage insurance versus the one-percent VA funding fee. We cannot comment on which method would provide the most advantageous funding method for the VA home loan guaranty program. We would, however, like to make some comments regarding mortgage insurance, based on our experience with the HUD FHA Title I manufactured home loan insurance program.

That program is designed to work as an insurance program on a portfolio of loans rather than as insurance on a loan by loan basis. This kind of program design leads to situations where a lender may find itself unable to have an insurance claim paid because insurance coverage, calculated in the form of reserves, has declined to zero.

Specifically, when an FHA Title I manufactured home lender makes an insured loan, a reserve (a book entry, not actual cash) of 10 percent of the loan is set up. At the end of every year, reserve balances are reduced by 10 percent. In addition, reserves are further reduced by claims paid. So, even if no claims are made, insurance reserves will continue to decline.

The problem with this method arises when economic conditions begin to decline and the lender stops making loans while experiencing increased claims. Since loan activity has ceased, insurance reserves are not growing. In fact they are declining with the passage of time at 10 percent per year. Reserves are further strained by claims that are increasing because of declining business conditions. The lender eventually finds itself in a position where reserves have declined to zero. No more claims will be paid, even though there may be loans remaining in the portfolio which are technically insured. As a practical matter, the lender finds itself in the same position as if it had an uninsured portfolio even though it is still paying for insurance.

This situation would not happen if insurance were applied to each loan and stayed with each loan for the life of the loan. Loan by loan insurance, such as private mortgage insurance (PMI), is the typical coverage provided by private insurers. We would urge the subcommittee to avoid the FHA Title I manufactured home loan insurance approach of establishing portfolio reserves as a criteria for claims payments should they decide to pursue an insurance program for VA loans.

We would hasten to add here that while we have great concerns about the reserve calculations of the FHA Title I loan insurance program, we think that there is substantial merit in eliminating some of the administrative and paperwork differences in the VA manufactured home loan guaranty program and the FHA Title I manufactured home loan insurance program. For example, the determination of maximum loan amounts, which items are eligible for financing, and the forms and other

paperwork that must be submitted on a loan are different for VA-guaranteed and FHA-insured loans. Achieving uniformity in these and other administrative areas to the maximum extent possible would encourage more lenders to make these government programs available to the low- and moderate-income buyers who need them.

VA Program Is an Entitlement Program

The VA home loan guaranty program is a benefit program authorized by Congress in recognition of the services provided by men and women in the service of their country as members of the U.S. armed forces. So, while we would encourage uniformity of administration in the VA and FHA programs where possible, we think it is important to keep in mind the entitlement nature of the VA program. One of the benefits of the VA program, for example, is that it requires no downpayment by the veteran on a home loan. (Although, this was recently changed for manufactured home loans to require a five percent downpayment.) To change the VA program so that these kinds of benefits are stripped from it would erase the benefit nature of the program. The result would be a program that provides no benefit to the veteran. We do not believe that this was the result that Congress intended when it authorized the program for manufactured housing in 1970.

It makes sense for Congress to seek ways to reduce costs to their lowest level. However, in doing so, it must keep in mind what the benefit is intended to do and the cost of removing that benefit as well as the cost of providing it.

Recent Losses on VA-Guaranteed Home Loans

It has been claimed that losses on VA-guaranteed manufactured home loans exceed those for site-built homes. We would respectfully submit to you that this is not the case. Claims paid on VA-guaranteed site-built home loans far exceed those paid on manufactured home loans in the aggregate because there are far more VA-guaranteed loans made on site-built homes than on manufactured homes. For example, for fiscal years 1980 through 1987, the VA guaranteed 1,982,584 site-built home loans for an aggregate dollar value of $127.4 billion. VA manufactured home loan guaranty activity for the same period was 74,831 loans for an aggregate dollar value of $1.6 billion. For fiscal years 1984 through 1987, VA claims on site-built home loans totaled 122,598 loans for an aggregate dollar value of $1.4 billion. VA manufactured home loan claims for the same period totaled 13,500 loans for an aggregate dollar value of $111.8 million.

COMPARISON OF VA-GUARANTEED SITE-BUILT VS. MANUFACTURED HOME LOANS IN 1980'S

FISCAL YEAR	SITE-BUILT HOMES LOANS	SITE-BUILT HOMES DOLLARS (IN THOUS.)	MANUFACTURED HOMES LOANS	MANUFACTURED HOMES DOLLARS (IN THOUS.)
1980	289,164	$14,653,112	8,283	$162,154
1981	178,239	9,821,789	9,389	187,156
1982	92,930	5,331,522	10,509	210,393
1983	231,620	14,389,968	13,502	280,293
1984	238,478	15,332,916	13,110	278,902
1985	170,015	11,262,756	8,916	188,992
1986	307,747	21,832,718	6,022	133,059
1987	474,391	34,783,518	5,100	116,533

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COMPARISON OF CLAIMS ON VA-GUARANTEED SITE-BUILT VS. MANUFACTURED HOME LOANS 1984 - 1987

FISCAL YEAR	SITE-BUILT HOME CLAIMS PAID LOANS	SITE-BUILT HOME CLAIMS PAID DOLLARS (IN THOUS.)	MANUFACTURED HOME CLAIMS PAID LOANS	MANUFACTURED HOME CLAIMS PAID DOLLARS (IN THOUS.)
1984	25,322	$216,065	2,714	$22,339
1985	26,911	288,407	3,366	27,687
1986	30,845	365,587	3,777	31,377
1987	39,520	516,824	3,643	30,350

Of greater interest however, is a comparison of VA-guaranteed loans on site-built and manufactured homes with similar price ranges and downpayments. The average claim on a VA-guaranteed site-built home loan in fiscal year(FY) 1979 was $4,865.44 for a home priced between $25,000 and $34,999 with a downpayment of under $1,000. In FY 1983 that average claim had risen to $7,645.95, an increase of 57 percent. And, this does not include the cost to the VA of property management on these site-built foreclosed properties, estimated by the VA at $5,600 per property. Taking the property management fee into account, the average cost of a site-built claim rose from $10,465 in FY 1979 to $13,245 in FY 1983. For manufactured homes, where there is no corresponding property management fee, the average claim per foreclosure rose from $10,217 in FY 1979 to $11,562 in FY 1983, an increase of 13.2 percent.

ESTIMATED AVERAGE COST OF CLAIMS ON VA-GUARANTEED LOANS FOR HOMES PRICED $25,000 - $34,999 AND DOWNPAYMENT LESS THAN $1,000 1979-1983, BY CONSORT YEAR

FISCAL YEAR	AVG. CLAIM SITE-BUILT	ESTIMATED PROP. MGMT COSTS SITE-BUILT	TOTAL COST OF CLAIM SITE-BUILT	AVG CLAIM MFG-HOME
1979	$4,865	$5,600	$10,465	$10,217
1980	$6,388	$5,600	$11,988	$11,047
1981	$7,636	$5,600	$13,236	$11,861
1982	$7,870	$5,600	$13,470	$11,618
1983	$7,646	$5,600	$13,246	$11,562

ESTIMATED TOTAL COST OF CLAIMS ON VA-GUARANTEED LOANS FOR HOMES PRICED $25,000-$34,999 AND DOWNPAYMENT LESS THAN $1,000 1979-1983, BY CONSORT YEAR

FISCAL YEAR	CLAIMS MADE SITE-BUILT	EST AVG COST PER CLAIM SITE-BUILT	TOTAL COST OF SITE-BUILT CLAIMS (IN THOUS.)	CLAIMS MADE MFG HOUSING	AUG COST PER CLAIM	TOTAL COST OF MFG HOUSING CLAIMS (IN THOUS.)
1979	4,737	$10,465	$49,573	72	$10,217	$ 736
1980	4,512	$11,988	$54,090	156	$11,047	$1,723
1981	2,908	$13,236	$38,490	286	$11,861	$3,392
1982	1,184	$13,470	$15,948	318	$11,618	$3,695
1983	625	$13,246	$ 8,279	164	$11,562	$1,896

In fact, when one compares claim rates for similarly priced homes, with loans guaranteed by the VA with downpayments of less than $1,000, the finding is that claim rates on manufactured homes are not much higher than those on site-built homes. In particular, of 112,966 VA-guaranteed loans made on site-built homes between fiscal years 1980

and 1986 in a price range between $25,000 and $35,000 with a downpayment of less than $1,000, 14,191, or 12.6 percent, defaulted. Of 8,203 VA-guaranteed manufactured home loans in the same category, 1,261 or 15.4 percent defaulted. This is not a surprising fact when one considers that families who purchase lower-priced homes do so because of their income levels. These lower-income families are no doubt higher credit risks. But, it is these families, more than any others, who need the benefits provided by programs such as the VA home loan guaranty program to have the ability to acquire adequate shelter.

The Causes of Manufactured Home Loan Defaults

The causes of defaults on manufactured home loans are similar to those on site-built home loans. In general these are bad or deteriorating economic or family conditions that neither lenders nor the VA can control. The manufactured housing industry has been experiencing declining sales of new homes over the last three years. 1987 shipments of manufactured homes were 21.2 percent lower in 1987 than they were in 1984. Even more dramatic are the declines in the south atlantic and south central regions where new manufactured home sales are concentrated. Sales of new manufactured homes in the south central region declined 48.5 percent from 1984 to 1987, and 29.8 percent in the south atlantic region. These two regions accounted for 65.7 percent of new manufactured home sales in 1984 and 57.6 percent in 1987. The decline of the oil based economy in the south central region is clearly responsible for the dramatic declines in that region. The reasons for the decline in the south atlantic region are less clear, but it is certain that the manufactured housing industry has been experiencing the effects of a business recession and the related credit effects on its customers.

Manufactured home buyers tend to fall into income levels that leave them particularly susceptible to poor business conditions. Information gathered in a national poll by Foremost Insurance Company, the largest insurer of manufactured homes in the U.S., indicates that the median income of a family living in a manufactured home is $19,900. A Study published March 10, 1986 by the VA Loan Guaranty Service indicated that "...many of the recipients of VA Manufactured Home loans were at income levels that might have qualified them for subsidized government housing programs. However, with the VA Manufactured Housing program these veterans have experienced home ownership and not had to live under the stigma of being 'on the dole.'"

MHI recently asked a number of manufactured home lenders to rank the causes of loan defaults by percentages. 53 lenders with aggregate manufactured home loan portfolios of $6.6 billion responded to the survey. According to the survey, the top four causes of manufactured home loan defaults were:

1. Economic dislocation - unemployment (local recession, major plant shutdown, etc.) 30%
2. Marital discord (divorce, separation, etc.) 25%
3. Bankruptcy (debt overload) 20%
4. Major family illness 6%

With this information in mind, we would urge the subcommittee to monitor the results of the stricter home loan qualification guidelines imposed by the VA in the fall of 1986. We understand the subcommittee's desire to find a permanent solution to the solvency problem of the VA home loan guaranty program but, we would urge them to consider carefully before removing the benefits of this program for all veterans in a reaction to economic conditions that were beyond the control the VA, lenders and veterans.

Conclusion

We believe that the VA home loan guaranty program has provided a valuable benefit to veterans by allowing them to experience the pride and satisfaction of home ownership. Many of these people would not have had that opportunity without the program. In particular, the VA manufactured home loan guaranty program provides this home ownership opportunity to low- and moderate-income veterans who have no other housing choices at their income levels. We respectfully urge the subcommittee to remember the entitlement nature of the program in its deliberations and to consider the effect of taking away some of these benefits from the veterans who have earned them, just as carefully as it considers the cost of providing these benefits.

As the subcommittee examines alternative solutions to the solvency of the VA manufactured home loan guaranty program, we would urge that it examine those solutions in light of their effect on the eligibility of VA-guaranteed manufactured home loans for the Government National Mortgage Association secondary market program for manufactured home loan pools. Unlike site-built home loans, the manufactured housing industry's only access to an organized secondary market program for home loans is through the GNMA program for VA-guaranteed and FHA-insured loans. Since most VA-guaranteed loans are pooled into the GNMA program, the loss of this program would likely cause lenders to cease making VA-guaranteed manufactured home loans. This would deny many veterans the only source of low-cost housing available to them at their income levels.

STATEMENT OF MARTIN HECK

PRESIDENT

NATIONAL MANUFACTURED HOUSING FINANCE ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON HOUSING AND

MEMORIAL AFFAIRS

COMMITTEE ON VETERANS' AFFAIRS

HOUSE OF REPRESENTATIVES

MARCH 17, 1988

Madam Chairwoman and Members of the Subcommittee:

My name is Martin Heck. I am president of Home Owners Funding Corp. of America, and president of the National Manufactured Housing Finance Association ("NMHFA" or the "Association"). Accompanying me is James Brodsky of Weiner, McCaffrey, Brodsky & Kaplan, counsel to the NMHFA. The Association is pleased to have this opportunity to testify before the Subcommittee on the Veterans Administration ("VA") home loan guaranty program.

The NMHFA is comprised of lenders and others interested in the financing of the retail purchase of manufactured homes, both conventionally and through the use of the programs of the Veterans Administration and the Federal Housing Administration.

The Association commends Chairwoman Kaptur's dedication to the VA's housing programs and to examining suggestions for creating long-term solutions to the Loan Guaranty Revolving Fund's solvency, rather than looking for "quick-fixes" that ignore the underlying causes. Our comments today in response to the Subcommittee's request focus on improvements to the VA's manufactured housing loan guaranty program (38 U.S.C. § 1819) that would reduce the VA's high default rate and the losses from the Fund.

The manufactured housing finance community shares the VA's and the Subcommittee's deep concern with the losses experienced under the Section 1819 loan guaranty program. With every VA claim, the lender invariably experiences a financial loss. We want to see the VA manufactured home loan program strengthened rather than abandoned, whether by the Administration or by the lender community.

With many Americans finding that escalating real estate prices are squeezing them out of the housing market, the availability of the guaranteed home loan programs of the VA becomes more and more important. The VA housing programs are intended to provide a benefit to the men and women who served our country in the armed forces. Accordingly, the nature of the program should not be altered in such a manner that the veteran is denied a rightful entitlement.

Although the VA manufactured home loan program is a small part of the VA housing program, it is an important element in filling the veteran community's housing needs. Since its inception in 1971 the VA manufactured home loan program has been effective in providing good, quality, affordable housing to nearly 110,000 veterans and their families.

The VA's manufactured home loan program is particularly beneficial to low and moderate income veterans and active duty personnel and their families, affording them the opportunity to

own their home. As compared with the VA home loan guaranty program in general, the VA manufactured home loan program has a higher concentration of low and moderate income households. Veterans taking advantage of the VA manufactured home loan program, therefore, are likely to be financially less prepared to handle interruptions in their income stream. In such situations, an unforeseen financial crisis has a greater chance of tipping the scales so that default on the VA loan obligation becomes an unavoidable alternative. Consequently, to some degree, a default rate in the VA manufactured home loan program that is higher than the default rate with VA guaranteed loans overall is predictable. However, according to the VA, a comparison of the default rate for the VA manufactured home loan program with the default rate for VA loans on site-built housing in the $25,000 to $35,000 price range reveals that the default rates do not differ significantly. This observation suggests that a higher default rate is not an outgrowth of manufactured housing, but rather a by-product of the financial stability of the borrower.

We believe no single change can be applied to the VA manufactured home loan program that would produce significant reductions in the default rate. However, our testimony offers some suggestions for a number of changes and program improvements that individually may affect a small number of loans or situations, but cumulatively may produce a sizeable reduction in the default rate.

Our comments first examine the issue of mortgage insurance cited in the Subcommittee's invitation and then present our recommendations for other changes which we believe can lead to program improvements.

Mortgage Insurance v. Funding Fee

The Subcommittee has expressed an interest in exploring the possibility of replacing the one percent funding fee with a mortgage insurance program as a way of making the loan guaranty fund self-supporting. While we understand the Subcommittee's commitment to exploring funding mechanisms other than the one percent funding fee, which neither the Congress, the borrower, nor the lending community favor, we question the wisdom behind the adoption of a "VA mortgage insurance program." Such a change would undermine the entitlement nature of the VA program, moving further away from Congress' objective of guaranteeing that those who served our country have access to decent and affordable housing. It would eliminate the distinction between the housing programs of the FHA and the VA. What need then would there be for the federal government to operate the Federal Housing Administration and the "Veterans Housing Administration"? Administration critics of the VA's housing programs would be better armed to argue that the veterans' housing program could be folded entirely into the programs of the National Housing Act.

Moreover, we fail to see the benefit that would inure to the veteran by adoption of a mortgage insurance program. Such a VA program change likely would be structured after the U.S. Department of Housing and Urban Development's ("HUD") basic home mortgage insurance program, the Section 203(b) program. Under the Section 203(b) program, approved mortgagees have a contract of insurance, evidenced by a Mortgage Insurance Certificate ("MIC"), on each individual loan endorsed by HUD for insurance. In consideration of the insurance, HUD collects a mortgage insurance premium ("MIP"), which HUD permits the mortgagor to finance on top of the maximum loan amount. At present, the FHA one-time MIP for site-built housing loans is 3.8 percent of the mortgage loan amount. For manufactured home loans under FHA's Title I program, however, the assessed

insurance charge is 0.54 percent per year of the original loan amount. Both charges far exceed the VA's one percent funding fee. With the institution of an insurance charge for veterans housing programs, the veteran borrower, whether for a manufactured home or a site-built home, likely would incur greater financial exposure under a mortgage insurance program.

HUD's Title I program, which is the program under which loans secured by manufactured homes classified as personal property are insured, is not structured after the Section 203(b) program. The NMHFA would be opposed to the VA's adoption of an insurance program similar to the Title I reserve system, which we believe is flawed in concept. Unlike HUD's basic Section 203(b) program, the Title I lender and HUD enter into a contract of insurance under which the lender is insured, instead of HUD's providing insurance on individual loans. VA manufactured home loans, on the other hand, are individually guaranteed. The Title I reserve system is entirely a paper accounting which does not involve the placement of any funds into accounts. Reserves are accumulated with each new loan reported to HUD for insurance in the amount of 10 percent of the principal loan amount. Reserves accrue for a period of five years during which time the only deduction made to the reserve is the amount of any claim payment made by HUD to the lender. After the five-year mark, the lender's reserve is subject to an automatic annual 10 percent reduction, as well as the dollar-for-dollar reduction for claim payments. Upon exhaustion of the lender's Title I reserves, the lender is no longer eligible for claim payments. Thus, the only way to remain in the program is to continue originating loans sufficient to cover an entire portfolio. The system is a never-ending cycle of forced originations for the purpose of maintaining reserves.

Active Duty Personnel

As you know, the VA manufactured home loan program is available to active duty personnel, with VA guarantees permitted for active duty personnel with as little as 180 days of service. The program is intended to help provide off-base family housing for active duty personnel. In Fiscal Year 1987, over 51 percent of VA manufactured home loans were made to active duty personnel. As a result, the VA manufactured home loan program is heavily utilized in states with a greater concentration of military bases. Since the inception of the program, the six states of North Carolina, South Carolina, Georgia, Florida, Texas and Oklahoma have accounted for 57 percent of all manufactured home loans made nationwide and 63 percent of all claim payments.

While a weakened economy may have contributed to the high default rates in those six states, particularly in the economically depressed oil-patch states of Oklahoma and Texas, the manner in which potential default situations for active duty personnel are handled compounded the problem.

A significant number of claims occur when active duty personnel are transferred from one base to another and are forced to abandon their homes. Transferees in the lower ranks have little choice, since the Department of Defense is not willing to move the home to a new location for service personnel below certain grades. Claims also arise when active duty personnel are discharged or retire from the service.

Much can be done to improve the performance of loans made to active duty personnel in the above-mentioned situations. In many cases, homeowners do not receive sufficient notice of a transfer to have an opportunity to sell the manufactured home or find an assumptor for the loan. The DOD must be urged to do

more to provide timely notification to the active duty servicemember and to the lender when a transfer is approved or authorized. With a timely notification, an assumption of liability by another active duty servicemember could be effected more easily. In addition, every effort should be made by the VA and DOD to encourage assumptions in these situations. For example, a program to provide coordination among military bases to assist personnel facing a transfer to sell their homes or locate assumptors should be established. We urge the VA and/or DOD to develop a "housing bank"/housing referral service whereby military personnel seeking housing and those trying to locate a buyer/assumptor would have access to one another. Such a housing referral service also should be available to discharged and retired service members.

We also ask the Committee to seek the assistance of the DOD and its Base Housing Officers in two other problems that arise with some frequency with active duty military personnel. In those instances where an active duty servicemember defaults on his or her VA loan and abandons a manufactured home that was placed on a military base manufactured home park, the lender in some instances is not given the time or opportunity to sell the home on-site or to find an assumptor for the loan, but is pushed by the military to remove the home within ten days. Here, the DOD should be encouraged to work with the lender to find an assumptor for the home among active duty servicemembers who are looking to purchase a home. Otherwise a new home is financed, and a relatively new one is abandoned and claim is filed with the VA.

In the event of impending transfer, as with a looming default, a lender's loan servicing personnel routinely explain the consequences of default and repossession. The VA and/or DOD also should be looked upon to provide timely information to the active duty servicemember about the consequences of default and any assistance that might be available from the VA or DOD.

Collections

Theoretically, when a veteran borrower or active duty servicemember defaults on a VA home loan, any amount of claim paid by the VA constitutes a debt owed to the United States by such veteran or servicemember. We understand that the VA has been actively pursuing collections from defaulted obligors, including offsets of IRS refunds, but we believe the VA, together with the DOD should be more aggressive in pursuing collections from active duty personnel or discharged servicemembers who have defaulted on their VA guaranteed loans, and that such collections should be paid back into the Loan Guaranty Revolving Fund. Otherwise, the Fund is more rapidly depleted and veterans or active duty personnel obtaining new VA guaranteed loans are forced to pay the one percent funding fee to help maintain the solvency of the Fund.

Assumption Policy

Prior to enactment of the Veterans' Home Loan Program Improvements and Property Rehabilitation Act of 1987 (Pub. L. No. 100-198), lenders also attributed the high VA default rate to the VA's liberal assumption policy, which did not require that an assumptor be found creditworthy. The NMHFA hopes that we will see a reverse in default rates as a result of the new creditworthiness requirements. The leeway afforded in the Act for approvals of marginal cases in the event the assumption is in the best interest of the VA and the borrower should help to ensure that borrowers are given a fair chance when trying to arrange an assumption. We trust that the VA, in implementing the statutory changes, will strike the proper balance between an assurance of assumptor creditworthiness and the facilitation of assumptions.

Field Consistency

One of the most common complaints voiced by lenders is the inconsistency of guidance and interpretation of VA regulation and policy provided by field offices, which routinely vary from one another and from VA central. The lenders in NMHFA, and I trust lenders involved in other VA loan programs, may be based in one state or one region of the country, but they originate and service loans throughout the nation. We need consistency in the implementation of VA regulations governing the housing programs. Instead, each regional office operates as a separate fiefdom with little fealty to VA central. In NMHFA's November 12, 1987 letter to Chairwoman Kaptur, we cited this as one of the most exasperating problems experienced by the lender community. The VA's January 20, 1988 response to Chairwoman Kaptur's inquiry indicated that the VA currently is reviewing the draft of a staff manual for manufactured home loans that will be released to VA field offices to help ensure that program requirements will be applied in a more uniform manner, taking into account regional differences outside of the VA's control. While we recognize some flexibility may be necessary to handle regional differences that may arise, such as state and local laws, most VA requirements should not be subject to shifting interpretation.

Some examples of the conflicting guidance that have occurred may serve to illustrate the problem better. VA central has advised lenders that for conventional loans under the Veterans' Home Loan Program Improvements and Property Rehabilitation Act of 1987, the new assumption language was required on the mortgage or deed of trust and also on the note. However, one Texas field office has advised lenders that the language need only appear on the mortgage or deed of trust and not on the note. The St. Petersburg field office states that the date of closing for a manufactured home loan is the date the retail installment sales contract is executed. The South Carolina field office states that the closing date is the date of funding. The South Carolina field office requires an immediate reduction in the interest rate when the VA rate is lowered or, as an alternative, requires that an unconditional approval be given on the loan. Other VA field offices allow the lender to honor rates as quoted up to the 30-day period of commitment and do not require an unconditional approval.

This type of conflicting advice and policy interpretation makes it difficult for lenders to operate under the VA program. We cannot emphasize strongly enough the importance of a consistent application of VA requirements, particularly as lenders attempt to adhere to the changes brought about by the Veterans Home Loan Program Improvements and Property Rehabilitation Act of 1987. However, as the Act is being implemented, our worst fears are being realized -- inconsistent interpretation has even forced one lender to cease funding VA loans.

Appraisals

Appraisal delays are not a nationwide problem under the VA program. However, those lenders who do experience delays report a 60-120 day waiting period before obtaining VA appraisals on repossessed units. This delay translates into a 60-120 day delay before the home may be offered for sale and a claim submitted to the VA. During this period, the lender either must leave the home on-site until the appraisal is performed or repossess the home and store it on a dealer's lot pending appraisal. In either case, the lender bears the cost of the delay in terms of storage fees or park rentals, as well as the accrual of additional interest, and the refurbishing expenses in the event the home is vandalized. The failure to

obtain timely appraisals consequently hinders, if not negates, the resale efforts, and ultimately increases the amount of the claim filed with the VA. An alternative to consider would be a program adopted recently by the FHA, whereby appraisals on repossessed manufactured homes are performed by an independent organization that has contracted to provide the appraisals within a 30-day period.

Continuation of Liability Program

Our November 12 letter also presented information on the manner in which our lenders utilize the VA's continuation of liability program ("COL") and indicated that the COL program has proven successful in reducing the amount of claim payments upon borrower default. When a borrower defaults under the COL program, the lender, rather than selling the repossessed unit to a retailer at the appraised value and filing a claim with the VA based on the remaining principal balance, resells the repossessed unit directly to a consumer purchaser. Under the COL program, the home generally is sold for more than the appraised value and, as a result, the claim filed with the VA is much less. Moreover, the new purchaser enters into an indemnification agreement with the VA which provides that in the event of default, the new purchaser will indemnify the VA for any losses. The purchaser under the COL program is not required to be a veteran, thus opening up the pool of prospective customers, but if a veteran, he/she would not be required to use his/her VA entitlement.

We believe that the COL program could be more widely utilized and produce greater success if VA automatic lenders had the authority to process and fund COL cases within VA's prescribed underwriting guidelines without VA's prior approval. In its January 20 response to the Subcommittee, the VA supported our view that manufactured home lenders have the necessary expertise to process sales under the COL program without prior approval from a credit underwriting standpoint, but voiced reservations with regard to retaining prior approval for the interest rate, the borrower's indemnity agreement, and determining whether the individual sale is in the best interest of the Government. If the new purchaser meets the credit underwriting criteria of the VA, we question the need for prior approval. The VA could establish guidelines for processing COL cases, including requirements for setting the interest rate on such loans, and the language for the borrower's indemnity agreement. As with the assumption provisions under the new Veterans Home Loan Program Improvements and Property Rehabilitation Act of 1987, where the VA is not required to determine if the assumption is in its best interests if the assumptor qualifies from a credit standpoint, we believe prior VA approval would not be necessary under the COL program where VA's credit underwriting tests are met.

Irrespective of VA's reservations, we are pleased that the VA believes an expansion of the COL program has merit and we would be pleased to work with the VA to move the program forward expeditiously.

Dealer Approval

In our November 12 letter to the Subcommittee, we also recommended that the VA examine the FHA's dealer approval and monitoring requirements as an additional means to help curb program abuses, and reduce the number and size of VA claims. We were pleased to see in the VA's January 20 response to the Chairwoman that the VA is studying the FHA's dealer approval and monitoring requirements as a model for increasing the quality and stability of VA manufactured home loan program dealer participants. The VA, however, indicates that

significant changes to the VA program would require legislative authority not yet conferred on the VA. We would hope that the Subcommittee, upon completion of the VA study on dealer approval and monitoring requirements, would consider any necessary authorizing legislation. We also would hope the VA would implement requirements similar to those under the FHA Title I Program for dealer approval and monitoring that would include, among other things, approval guidelines, enhanced enforcement, and timely notice of suspended program participants. As the NMHFA has indicated, greater stability on the part of dealers, together with the imposition of more stringent dealer approval, monitoring and annual reapproval requirements, will enhance the performance of the VA manufactured home loan program and help check the VA's losses.

Standardization of Federal Programs

Lenders would very much like to see certain origination elements of the FHA and VA manufactured home loan programs more closely resemble each other. As both programs now stand, they bear no relationship to one another in terms of calculation of the loan amount; financeable items, fees and charges; underwriting requirements; loan documentation; dealer approval and monitoring requirements; or appraisal services. Both programs utilize separate credit applications, placement/completion certificates, and so forth. The FHA Title I program permits the charge for freight incurred from the manufacturing site to the selling site to be financed in its entirety. The VA limits the financing of freight to $400 for a singlewide home and $600 for a doublewide home. FHA permits the financing of set-up charges up to $600 per module, while the VA limits the financing of the set-up charges to $400 per module. The limitations set by the VA do not reflect current industry charges for freight and set-up. The dealer either must absorb the costs or the veteran borrower must pay them out of pocket in addition to the down payment required. Consequently, dealers do not encourage veterans to obtain VA financing.

Underwriting

The VA presently utilizes a residual income calculation for underwriting purposes. We would like to see the VA move to a debt-to-income ratio calculation in place of the residual income requirement. The FHA Title I program implemented a debt-to-income ratio requirement in connection with the rewrite of its regulations effective in January 1986. We believe the debt-to-income ratio provides a more accurate guideline for measuring the borrower's ability to repay the debt, while still allowing the lender to exceed the ratio guidelines in appropriate cases in which there are compensating factors, as permitted using the VA's residual guideline.

Five Percent Down Payment

The NMHFA did not oppose a down payment requirement at the time it was proposed last year primarily because it was presented as a compromise: either the VA guaranty would have been reduced to 30 percent with no down payment or 40 percent with a five percent down payment. The 30 percent guaranty would have caused many lenders to cease funding VA manufactured home loans, and in fact the 40 percent guaranty has led one lender to decide not to continue to make VA manufactured home loans. We also were not opposed to the imposition of a down payment requirement because we believe that a down payment provides the borrower with equity in the home, which may help to deter default and, in turn, reduce losses to the VA.

However, since implementation of the down payment requirement, lenders have found that veterans are opting instead to purchase comparably priced stick-built homes instead of manufactured homes in order to avoid having to make a down payment. With veteran borrowers who purchase homes in the $25,000 to $35,000 price range experiencing as high a default rate as buyers of manufactured homes, the ultimate effect of the down payment requirement may be to shift losses from the manufactured home loan program to the stick-built program. We recommend that the VA closely monitor this area. If the default rate is shifted from one area to another, there would be no reason to retain the five percent down payment on manufactured home loans.

Refinancings

My company, Home Owners Funding Corp. of America ("HOFCA"), recently worked with the VA to develop a program for the refinancing of delinquent loans that would help reduce the default rate and allow the veteran borrower to keep his or her home. We want to be able to offer to borrowers who are delinquent on their accounts, but who may be better able to keep current on a loan with a lower interest rate, the opportunity to take advantage of an interest rate reduction refinance. For such borrowers, we would capitalize their delinquent interest into a new principal balance, extend the loan term and reduce the interest rate, to try to lower the monthly payment. Our intent is to permit the refinancing of delinquent accounts to avoid repossession, and not merely to delay repossession. We have not yet implemented the program, but plan to test approximately 50 loans initially and to evaluate the response to the program. The VA has demonstrated a willingness to work with the industry to provide such creative solutions within its statutory authority, and should be encouraged to continue to pursue such solutions with lenders.

The National Manufactured Housing Finance Association appreciates this opportunity to express its views to the Subcommittee. The Association applauds the efforts of the Subcommittee to improve the VA's housing programs and urges the Subcommittee to adopt the NMHFA's recommendations.

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STATEMENT OF

BILL T. HYLTON, SRA

CHAIRMAN, PUBLIC AFFAIRS COMMITTEE

SOCIETY OF REAL ESTATE APPRAISERS

BEFORE THE

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

HOUSE VETERANS AFFAIRS COMMITTEE

March 17, 1988

Washington, DC

Thank you Madam Chairwoman, and members of the Subcommittee. My name is Bill Hylton and I am Chairman of the Public Affairs Committee of the Society of Real Estate Appraisers. With me is Don Kelly, Legislative Counsel.

The Society was founded in 1935 as an independent, voluntary membership organization and continues as such today. During the chaotic period of the depression, the need for uniform standards of appraisal procedures and formalized appraisal training arose when foreclosures were common and there was little market against which housing prices could be compared. Members of the newly formed Society created the standards of a new profession and, indeed, created that needed profession itself.

The purposes of the Society are to elevate the standards in real estate appraising and analysis, to aid in the solution of problems the profession faces in appraising and analyzing real estate, and to designate certain of our members as having attained demonstrable skills and knowledge. Our members are pledged to maintain a high level of trust and integrity in their practice. It is the responsibility of our members to keep up to date with techniques, tools, and market practices; to know and utilize data sources, and to be aware of the influences in which client decisions must be made.

In order to assure the public of the highest standard of appraisal service, the Society has intensive training programs and offers educational courses in all areas of real estate appraising. Our Standards include the requirements of an appraisal, and we specify professional standards by which appraisers must conduct their practice. All of our members are obligated to abide by the Uniform Standards of Professional Appraisal Practice.

Membership is open to all persons of good character with a serious interest in appraising, and who desire to undertake a rigorous educational program in order to earn our professional designations: SPA, SRPA, or SREA.

Our Standards specify that the appraiser's compensation must be based on the "responsibility entailed and the work and expense involved". Society members are precluded from accepting compensation for services in the form of a commission, rebate or division of brokerage commissions where the appraisal assignment and involvement in the sale or brokerage of the same property would constitute a conflict of interest. Members cannot accept compensation for an appraisal which is contingent upon the appraised value of that property.

The VA Home Loan Guaranty Program was established by Congress under the Servicemen's Readjustment Act shortly before the end of World War II to help the Nation's returning veterans obtain homeownership. The nature of an entitlement program such as this is very different from that of a traditional financing program. Strong public policy to provide affordable housing for veterans may not be fully implemented by reliance on tne conventional mortgage marketplace. Entitlement programs cannot survive without appropriations from Congress.

The additional funding requested by the Veterans Administration in Fiscal Year 89 to cover the losses that have been incurred by the VA Home Loan Guaranty Program makes clear that the viability of the program may now be threatened. This Subcommittee has held oversight hearings on this subject last session, and they included a look at the appraisal process. In other Congressional investigations, it has been reported that the Inspector General for the VA has found deficiencies in the

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performance of VA-approved appraisers. The Society of Real Estate Appraisers is committed to the need for qualified appraisers to perform quality appraisals. Sound independent appraisals are essential in assuring that real estate loans guaranteed by VA and others are properly supported. Uniform qualifications and standards for the appraisal profession can help give such assurance.

The independence of the appraiser in the mortgage finance process is critical. Appraisers should not have direct pressures placed on them by lenders and other users of appraisal services. Pressure to produce a predetermined number or value jeopardizes the appraisal process and puts lenders and insurers at risk. Appraisers need protection when they resist these pressures in the marketplace. Regulatory relief is needed which will focus on those applying such undue pressure.

The Society commends this Subcommittee for the steps it has already taken to address this concern. By enacting Public Law 100-198 at the end of last year, the law now requires that VA appraisers have appraisal experience, pass a written test, and submit a sample appraisal report. This should be beneficial in helping to reduce the losses to that program caused by problem appraisals.

To this same end, the appraisal profession has joined together to create the Appraisal Foundation. The Foundation has jurisdiction over the Uniform Standards of Professional Appraisal Practice which are adhered to by all members of the eight professional appraisal organizations. The Foundation is also charged with development of appraiser qualification criteria which will provide users of appraisal services with assurance that those appraisers so qualified will possess the necessary expertise to fulfill a given assignment.

Moreover, the Society has cooperated with the VA and other agencies in development of a Uniform Residential Appraisal Report which is currently in use by VA, FHA, Farmers Home, Fannie Mae and Freddie Mac. This form is an indication of VA's commitment to quality appraisals and is a significant step by the industry toward more consistency in appraisal reporting.

The Society provides a wide range of educational opportunities for all appraisers and has always helped to disseminate information relevant to government programs whenever possible.

The integrity of guaranty programs, such as the VA program, relies much upon properly supported appraisals. To the extent that the Society can be of assistance to maintain this goal, we look forward to working with this Committee and the VA.

Thank you.

Statement of

The American Legion

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WASHINGTON, D. C. 20006

by

E. PHILIP RIGGIN, DIRECTOR
NATIONAL LEGISLATIVE COMMISSION
THE AMERICAN LEGION

and

DENNIS K. RHOADES, DIRECTOR
NATIONAL ECONOMICS COMMISSION
THE AMERICAN LEGION

before the

SUBCOMMITTEE ON HOUSING & MEMORIAL AFFAIRS
COMMITTEE ON VETERANS AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

on

VA HOME LOAN PROGRAM

March 17, 1988

STATEMENT OF
DENNIS K. RHOADES
DIRECTOR,
NATIONAL ECONOMICS COMMISSION
THE AMERICAN LEGION

before

THE SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
COMMITTEE ON VETERANS AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

March 17, 1988

Madame Chairman, The American Legion appreciates the opportunity to appear before the subcommittee today to share our views on appropriate ways of dealing with the substantial increases in the cost of the VA Home Loan Guaranty program over the past ten years. We certainly share the concern of the Committee over the apparent hemorrhaging of the Loan Guaranty Revolving Fund (LGRF), which since 1984 has required appropriations to remain solvent. Fiscal years 1988 and 1989 will require the largest appropriations in the history of the program, at $389 million and $658 million respectively. From these numbers, the program appears to be sinking ever deeper into a financial morass, despite efforts by the Congress on an annual basis to come to terms with problem. While much of the resulting legislation--particularly P.L. 100-198--shows considerable promise through efforts to improve basic program operations as a whole, The American Legion believes that it is now time to examine the program in the context of the nation's economy, and to seek solutions to the LGRF solvency crisis by examining the basic issue of the Fund's financial structure.

Let me begin by observing that there is a common misperception of the VA home loan program as a self-sustaining operation which has recently come to grief solely because of poor management and excessive liberality in evaluating the capacity of the veteran to qualify for a VA backed mortgage. One of your counterparts in the Senate recently went so far as to observe that the program "was a business, and should be run like a business." The common perception that the LGRF has until recently been self sufficient, however, is largely myth. By its very

nature, the Loan Guaranty program is designed to run at a deficit, except for those unusual years when inflation in real estate values permits the VA to recover both its investment in foreclosed properties, as well as property management costs.

During the first seventeen years of the program's life, in fact, Congress appropriated monies directly into the VA's readjustment account to cover its costs. In all, Congress provided nearly $730 million for the program between 1944 and 1962, or roughly $3 billion in 1988 dollars. In 1962, the Loan Guaranty Revolving Fund (LGRF) was established for the dual purpose of paying program costs, and receiving its collections from the sale of property and receipt of overpayments. In only eleven of the twenty-six years since 1962 has the LGRF operated at a surplus. Moreover, since the law prohibits carryover of monies in excess of estimated need from one year to the next, a cumulative surplus has never developed in the fund. All funds over and above those estimated to be needed to supplement the receipts of a new fiscal year revert to the Treasury.

Yet, between 1962 and 1984, there was no need to appropriate general revenues for the LGRF, because the fund was sustained by income from another source: the VA's Direct Loan program.

Established in 1950, the Direct Loan program, in which the VA itself is the lender, was developed to meet the mortgage needs of veterans living in areas where private credit was short or nonexistent. The Direct Loan program was initially capitalized through appropriations by Congress, but also relied upon a Revolving Fund into which principal and interest payments were made. During the first six years of the program's life, direct loans accounted for two to five percent of total VA homeloan activity. The tight money supply occasioned by the dual recessionary period of 1958-1961, however, greatly increased the demand for direct loans dramatically. In 1961, 16% of all VA loans were direct. Thereafter, this proportion declined gradually, owing to the greater availability of private credit, until by 1984, only 8 of the 214,443 VA homeloans were direct.

In fact, except for rehabilitation loans, the Direct Loan program has been effectively shutdown since March of 1981. Because of the decline in the numbers of direct loans over the years, the principal and interest payments into the Direct Loan Revolving Fund exceeded the demand for loans, and the fund began to develop a large surplus. Monies from that surplus were transferred, as needed into the LGRF, thus obviating the need for appropriations to cover funding for those years in which the LGRF's receipts fell short of its payouts in property acquisitions and claims resulting from foreclosures. Between 1962 and 1984, approximately $1.784 billion was so transferred from one fund to the other.

As the Direct Loan program's surplus increased, the VA came under increasing pressure to sell off part of its portfolio for cash to offset growing Federal budget deficits. As such deficits grew wildly during the early 1980s, the pace of portfolio liquidation increased significantly and income from the program shrank proportionately.

Between 1981 and 1984, nearly $2 billion in the portfolio was sold. The Administration's FY 1989 budget proposes to sell the remainder. Thus the primary source of supplementary income to support the LGRF during lean years has been virtually depleted to effect shortterm Federal budget savings.

The elimination of the direct loan portfolio as a revenue instrument for its sister loan guaranty program could not have come at a worse time. For over thirty years, the VA home loan program was the beneficiary of not only an ancillary funding source to assist during periods of shortfall brought on by economic downturn, but also benefited from gradual inflationary growth in real estate prices from 1944 until 1977. It is important to realize that prices increased nearly 200% during those years. After that period, however, the sequence of uncontrolled and rapidly accelerating inflation, followed by recession, rising interest rates and growing VA property inventories began to place the greatest strain upon the LGRF since the fund's creation in 1962. Beginning in 1981, the LGRF began to show a widening disparity between the monies it payed

out for acquiring foreclosed properties, and the monies received for selling these properties.

In 1982, Congress imposed a 1/2 of 1% "user fee" on all new VA Home Loans. Touted as a means of helping to pay for the operational costs of the homeloan program, the money was collected and deposited as general revenue in the Treasury. As it became apparent that Congress might have to appropriate funds to sustain the solvency of the LGRF, the fee was raised to 1%, and the law provided that its revenues would go to the Revolving Fund.

Nevertheless, in 1984, for the first time in twenty-one years, Congress was forced to appropriate money for the VA Home Loan Program, in the amount of $100 million, and appropriations have been required every subsequent year. The data provided in the President's budget for 1988 and 1989 demonstrate that the funding crisis for the program, far from being over, has ballooned enormously. Although the 1988 budget for the VA calls for an appropriation of $389.8 million for the LGRF, a close reading of the President's 1989 budget, with its 1988 projections, shows that the VA will have to request an additional $526.6 million in a supplemental appropriation this spring, thus bringing the total appropriation for 1988 to $916.4 million, three times the size of the largest prior appropriation made to the program.

No one disputes that the economic downturn in the oil patch states during the past several years has been the single major contributing factor to the inability of the LGRF to recover from the 1981-1983 recession. Yet, The American Legion believes that we should not be lulled into thinking that improvement in the region will spell an end to the solvency problems of the Fund, particularly with the demise of the Direct Loan program as a source of supplemental funding. There are always going to be areas with local economic difficulties, as well as recurring national recessions. The fact remains that LGRF is becoming increasingly dependent upon massive infusions of general revenue to sustain itself.

The United States itself is struggling with an economy very much in transition, one in which its industrial base no longer serves as its labor force base. Instead, the economy is becoming increasingly a service economy. This transition is changing the face of both business and finance. It thus appears that the major problem with the LGRF is not how the program is administered, but how it is financed in the context of an economic base that has been substantially transformed since the 1950s and 1960s. The assumption that the LGRF, should be self-sustaining in 1988 or any other year if only program management were improved, is being seriously challenged.

The American Legion believes that addressing the financial problems of the Home Loan Guaranty program requires two approaches. The first, attempting to tighten and improve underwriting within the agency, has been the focus of the Committee's efforts over the last several years. As we have indicated, these efforts are not likely to show up immediately, since foreclosures resulting from previous years are still very much with us. You have also attempted to improve the VA's marketing of properties which we believe has improved the VA's inventory generally. Yet, the collapse of oil prices has led to severe real estate price deflation in areas such as Texas, Oklahoma, Louisiana and Colorado, so that fully 40% of the agency's total inventory of properties at the end of 1987 was concentrated in just these four states. It has been suggested that the VA should acquire foreclosed properties only if loss on such properties is less than if the agency simply paid off the guaranty. That appears to make good financial sense to us. What concerns The American Legion, however, is the effect such policy might have upon the future availability of credit in economically depressed areas. We might suggest that as a corallary to such policy, the Committee might want to examine the feasibility of opening up the Direct Loan program to accomplish its original intent: to make available loans in areas where credit for VA guaranteed loans is not available.

If it is acknowledged that the Loan Guaranty Program is designed to operate by its very nature at a deficit, and if the Direct Loan program no longer has the resources to offset such a deficit, there are fundamentally two choices--either accept the need for continuing appropriations for the program, or begin reestablishment of a revenue source which could, within perhaps seven to ten years, supplant the need for general revenues to support the program. We readily recognize that such solutions will require continued appropriations. There is, however, no shortterm solution which will not require additional appropriated revenues, other than eliminating the home loan benefit entirely.

There is currently a proposal in the Administration's 1989 budget which deals with the LGRF financing issue. According to VA's budget summary, the Administration will request legislation to "reform" Federal credit. This legislation will supposedly calculate in dollars the benefit granted by the Federal government in each of its credit programs and deposit such a sum for each transaction in the Treasury. Under this measure, the dollar value of the benefit which the home loan program grants to veterans is 6.6% of the loan guaranteed. It appears as if this fund will eventually replace the Loan Guaranty Revolving Fund--and indeed all similar funds--as the source of revenue to settle claims, manage property, and acquire homes. This proposal, however, raises many questions. What authority, for example, would this legislation give the Treasury over program policy? Treasury could conceivably be put in the position of dictating program operations to the VA. Equally as important, it is probably naive to believe that the Federal credit "reform" legislation would represent merely a transfer of payout authority. Instead, it would appear that the Federal credit programs involved are being targetted for abolition by those elements in the Office of Management and Budget who believe that the Federal government does not belong in the credit market under any circumstances. Certainly, the high potential cost of this legislation would argue strongly for such removal. While Congress is agonizing over a $685 million appropriation for the LGRF in

1989, the Administration's proposal would add another $1.3 billion to the cost of the program---and that is only in the first year. Perhaps the most charitable interpretation which can be rendered of this proposal is that it constitutes an extremely costly form of mortgage insurance.

The development of mortgage insurance to sustain the LGRF is another income alternative. The FHA program has long had mortgage insurance as a part of its loan package. Under the FHA plan, 1/2 of 1% of is added to the interest rate of the loan, and these revenues are collected by FHA and placed into an insurance fund. To date, that fund has a $2 billion surplus, despite the fact that FHA foreclosure rates are even higher than those for the VA. The disadvantage of private mortgage insurance is that its cost would be borne by the veteran--approximately $25-30 monthly for an average $70-80,0000 loan. This increased cost could eliminate from participation precisely those veterans with low to moderate incomes that the program was originally designed to serve. In addition, even though the veteran will ultimately pay for developing this revenue source, Congress will still be forced to appropriate funds until the insurance fund reaches a point at which it is self-sustaining.

Still another approach to dealing with the growing cost of the Home Loan program is the development of a new, income generating property portfolio. A moment ago, we discussed reopening the Direct Loan program in areas where a VA credit shortages exists. Additionally, a revenue-generating portfolio could be built with vendee loans which are retained by the agency, rather than sold. While this course of action obviously has budgetary implications over the shortterm, it represents a serious longterm alternative to the program's financing problems. In any case, it would most certainly be less costly than the Administration's Federal Credit Reform proposal, and merits serious study.

Madame Chairman, early this year, Senators Cranston and Murkowski introduced S 2049, a bill which would create an independent commission to study the financial problems of the

LGRF. The nine member commission would allow experts in real estate and finance, as well as the veterans organizations the opportunity to examine the LGRF and develop means to resolve its financial crisis. Although we are somewhat wary of Commissions of this sort, The American Legion could support the establishment of such a Commission with two modifications to the current bill.

First, the bill should emphasize in the Commission's charge, that any recommendations made are unequivocally in the best interest of the veterans the VA Home Loan Guaranty Program was designed to serve. The legisltion must preclude the possibility of a "runaway" commission in the hands of ideologues such as those who proposed the Federal Credit Reform initiative. The interest of America's veterans must come first. We are not suggesting that measures to prevent veterans from taking on mortgages which they cannot afford are not entirely appropriate. What we are suggesting is that the program's original purpose ,to permit veterans who do not have the cash resources or an established credit history, should not be shunted aside in the course of the Commission's deliberations.

Second, the veterans community ought to be represented by three seats on the Commission, rather than the two presently contemplated. Veterans are, after all, the program's consumers, not bankers, nor the realtors. Provided the interest of veterans is adequately protected, as suggested above, an independent Commission could do some highly creative work in helping to resolve the financial problems of the program.

It is important to emphasize that there are no shortterm solutions to the LGRF problem. It has been suggested that perhaps the program should be moved to another Federal agency to alleviate the pressure on the VA's total budget. The reality is that whether the program is at the VA or some other Federal agency, we realize that Congress will be unable to sustain the program through appropriations indefinitely. The real question concerns the future prospects for a Federal housing assistance program for veterans in any venue. If the VA Home Loan, which has afforded 12.7 million veterans the opportunity to own their own homes, is to continue, long range financing initiatives must be developed.

STATEMENT OF
STEPHEN L. EDMISTON
DEPUTY NATIONAL LEGISLATIVE DIRECTOR
DISABLED AMERICAN VETERANS
BEFORE THE
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
OF THE
HOUSE COMMITTEE ON VETERANS AFFAIRS
MARCH 17, 1988

MADAM CHAIRWOMAN AND MEMBERS OF THE SUBCOMMITTEE:

On behalf of the more than one million members of the Disabled American Veterans, may I say how very much we appreciate the invitation to be here today to provide our views, suggestions and recommendations on the solvency of the VA Home Loan Guaranty Program.

At the outset, Madam Chairwoman, the DAV wishes to commend you and the members of the Subcommittee for the serious oversight and legislative efforts you have undertaken during the past 14 months to address the various problem areas and critical deficiencies in the VA Home Loan Guaranty Program. And, in light of these continued difficulties, the scheduling of today's hearing is most appropriate.

Your letter of invitation indicated your intent "to explore the benefits of mortgage insurance versus the current one percent funding fee; the setting up of an insurance pool which could be invested; maximizing the Government's returns on its loan assets either through sales or holding them for the collection of interest or renting certain foreclosed properties in economically depressed areas until such time as the homes could be sold at a better rate."

The DAV is extremely pleased to have an opportunity to comment on these possible remedies to the solvency problem of the VA Home Loan Guaranty Revolving Fund, as well as provide some additional suggestions and recommendations that we believe may also address this problem.

However, any changes to the current program must, in our view, ensure that the fundamental focus of the program -- to assist eligible veterans in obtaining mortgage credit without a down payment for the purchase of existing or manufactured homes and construction of new homes -- remains fully in tact.

Furthermore, Madam Chairman, we are firmly convinced that any legislative and regulatory programmatic changes must be based on sound business and financial practices that protect eligible veterans' entitlement to the program, as well as the American taxpayers' investment.

In this regard, the current Administration has, in our view, employed faulty business and financial practices that have intensified the solvency problem of the Loan Guaranty Revolving Fund. For example, this Administration has consistently pursued (1) a reduction in staffing of loan guaranty personnel; (2) charging large user fees to veterans wishing to utilize the program; (3) selling off large portions of the portfolio assets at bargain basement prices; and (4) seeking the enactment of a major credit reform proposal that would ultimately eliminate the existence of the VA Home Loan Program.

These shortsighted management, business and financial practices, coupled with severe economic downturns in certain areas of the country, fraudulent practices by appraisers and

other forms of fraudulent activities such as equity skimming, kickbacks in the mobile home industry and false credit reporting, have culminated in the current crisis facing the VA Home Loan Program and Revolving Fund.

Madam Chairwoman, the idea to establish a mortgage insurance fund or pool is outstanding and represents a more meaningful use of taxpayer dollars, rather than the current one percent users fee. Utilizing the current criteria requiring payment of the users fee and the existing, well established VA Insurance Program, we believe an equitable program of mortgage insurance can be created to ensure the future solvency of the Loan Guaranty Revolving Fund.

For example, we envision the establishment of a mortgage insurance pool as an entity under the auspices and supervision of the current VA Insurance Program. In this regard, it is significant to note that the Administration, in their Fiscal Year 1989 budget request, has requested the enactment of legislation to transfer the current Veterans' Mortgage Life Insurance Program from one being administered by a commercial insurance company to an in-house operation. The Administration claims that "this change to an 'in-house' operation will result in a savings of approximately $100,000 a year with a corresponding reduction in the subsidy, currently estimated to be $4.25 million."

Quite frankly, Madam Chairwoman, the VA Insurance Program has an outstanding proven track record in such matters, therefore we strongly support placing any mortgage insurance pool that may be created within their jurisdiction of responsibility. Furthermore, any insurance pool created must include sufficient staffing to efficiently administer the program.

Also, the creation of any mortgage insurance pool must have express statutory authority to invest such funds that the pool may acquire to enhance the funds' financial stability to meet any and all claims. In our view, no such funds designated for a mortgage insurance pool or program should be deposited in any general Federal Treasury fund.

With respect to the funding of such a mortgage insurance pool, we believe these costs should be borne from a number of different sources. First, the current user fee requirement should be abolished. As you know, the DAV has always been opposed to requiring a veteran to pay for the privilege of using an earned benefit entitlement. However, we recognize and fully understand the financial dilemma of the VA Loan Guaranty Revolving Fund, therefore, utilizing the same eligibility criteria currently in effect (of veterans who are required to pay the users fee), the establishment of a quarter percent mortgage insurance fee, to be matched by the federal government, would ensure that those veterans paying such a fee would receive full protection against any indebtedness that may result from a foreclosure on their VA guaranteed home loan.

We believe such a fee paid by a veteran could be deposited in full at the time of closing on a VA guaranteed loan or amortized over the life of the loan, the option being left to the veteran.

Furthermore, we strongly believe that <u>all</u> service-connected disabled veterans (including those rated 0% disabled) utilizing the VA Home Loan Program should be exempt from paying the mortgage insurance fee. However, service-connected disabled veterans, in our view, should receive the same full protection from such a mortgage insurance pool, with the VA providing the full mortgage insurance fee for such veterans.

In addition to the fees collected from veterans and matched by the VA, we believe any legislation crafted to create such a mortgage insurance pool should require any and all funds, fines, settlements or penalties collected from any source as a result of schemes that have defrauded veterans and the Veterans Administration to be deposited in the insurance pool.

As an example, such practices as fraudulent appraisals, equity skimming, kickbacks, false credit reporting and poor origination practices by automatic lenders, to name a few that may result in the payment of funds to the Government as a result of fines, penalties or settlements should be deposited in the insurance pool. We also firmly believe that such legislation should establish stiff fines and penalties for any individual or institution found defrauding veterans (using the VA Home Loan Program) or the Veterans Administration.

Earlier in our testimony, Madam Chairwoman, we expressed our dissatisfaction with the Administration's poor business and financial practice of selling the VA's portfolio assets at bargain basement prices.

As you know, the Administration is continuing their efforts in this area as noted from their proposed Fiscal Year 1989 budget request, wherein they propose sales of loans without recourse to provide funds to the Loan Guaranty Revolving Fund.

In 1987 the VA attempted such a sale, which was subsequently withdrawn, because it was reported that offers on the proposed sale ranged from a low of 15¢ to a high of 55¢ on the dollar of the face value of the loans.

Furthermore, in 1987 the VA conducted an auction in Houston, Texas in an effort to reduce the number of properties they held in that area. It is our understanding the VA received an average of 40¢ on the dollar for the property sold at that auction. Quite frankly, this is no way to run a business or manage the American taxpayers' dollars.

As you know, the VA informed the Veterans Affairs Committees during recent budget hearings that they had recently acquired the services of a financial advisor to assist them in these areas. Certainly this could be a move in the right direction, so long as this financial advisor is not forced to work within the parameters of the OMB mentality.

Clearly, sound management, business and financial decisions regarding the VA Home Loan Program are critical to both its short and long term solvency and viability. VA budget documents indicate Fiscal Year 1988 will see a record number of foreclosures on VA guaranteed loans.

Therefore, now is the time to act. While a mortgage insurance pool, as we noted earlier, can address the long term solvency of the program, new innovative actions need to be taken now to address the short term problems.

Madam Chairwoman, your letter of invitation sought to explore the benefits of "maximizing the government's returns on its loan assets either through sales or holding them for the collection of interest or renting certain foreclosed properties in economically depressed areas until such time as the homes could be sold at a better rate."

The DAV believes good business practice tells us that all of these avenues could be utilized. For example, if the VA can sell loan assets at 100% of par then they should sell, but if that is not possible, they should hold them and collect the interest. Furthermore, if the VA is holding properties, such as

in Houston, that can not be sold at a fair market value due to the depressed housing market in that area, then it only makes good common sense to rent them until such time as local economy improves.

Obviously, at least to us, this makes good sense. Unfortunately, the VA is not able to address their current problems in such a manner due to OMB dictate. As noted earlier, concerning VA auctions and loan sales, the American taxpayer took a beating. Had OMB given VA authority to request and obtain funding for sufficient personnel most of these severe losses could have been avoided.

Today in Houston, for example, the VA never contacts a veteran until his loan has gone into foreclosure. The ratio of the number of properties in VA custody to the number of employees working in VA property management is almost 200 to one, while the national average is 95 to one.

Madam Chairwoman, we believe the answer is clear -- the VA Home Loan Program is grossly understaffed. We believe the VA should establish management teams with sufficient personnel that can be setup in areas like Houston, Denver and other areas experiencing high rates of foreclosures for the purpose of assisting veterans in default on their loans, and to manage properties the VA has already acquired.

Quite frankly, we support the idea of the VA renting properties until market conditions improve. Certainly Houston would be ideal for such a program as it appears that the economy of that area may be turning the corner and be on its way back up. A recent article appearing in "Insight" Magazine dated March 14, 1988, reveals that during the past year "city officials eager for new business have combined to bring in at least 55 relocations or expansions in the area... creating as many as 7,000 jobs."

It is also important to note that legislation (S. 2049) has been introduced in the U.S. Senate that proposes to (1) establish an independent National Commission on the Veterans Administration Home Loan Guaranty Program; (2) authorize reductions in the interest rate on vendee loans made by the VA to finance the sale of properties acquired as a result of foreclosure; and (3) establish creditworthiness requirements for assumptions of VA vendee loans.

The DAV believes that those provisions of S. 2049 that extend authority to the VA to reduce interest rates on vendee loans (under certain circumstances) and establish creditworthiness standards for assumptions of vendee loans are meaningful and we urge the Subcommittee to give favorable consideration to these proposals.

With respect to the provision of S. 2049 that creates an independent commission to assess the VA Home Loan Guaranty Program, no matter how well-intentioned, we believe it comes too late. That is, by the time the commission can report to the Administration and the Veterans Affairs Committees, and all have an opportunity to react, both with regulatory and legislative actions, possibly two or more years will have elapsed before meaningful, effective changes can be implemented to improve the program.

One final recommendation, Madam Chairwoman. We urge the Subcommittee to give serious consideration to increasing the VA's authority to provide more direct loans. We believe such loans will further strengthen and stabilize the financial solvency of the overall program.

In conclusion, the DAV urges the Subcommittee to move forward with legislation this year that will preserve the integrity of this valuable program. Such legislation, in our view, should:

* Create a mortgage insurance pool;
* Provide sufficient staffing for the VA Home Loan Program;
* Require the VA to better manage the program in the interest of veterans and the American taxpayers; and
* Increase the number of direct loans the VA is authorized to make.

This concludes our testimony, Madam Chairwoman. Again, I wish to thank you and the members of the Subcommittee for allowing the DAV this opportunity to express our views on this important program.

STATEMENT OF

DENNIS M. CULLINAN, ASSISTANT DIRECTOR
NATIONAL LEGISLATIVE SERVICE
VETERANS OF FOREIGN WARS OF THE UNITED STATES

BEFORE THE

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
COMMITTEE ON VETERANS' AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

WITH RESPECT TO

SOLVENCY OF THE VA HOME LOAN PROGRAM

WASHINGTON, D. C. MARCH 17, 1988

MADAM CHAIRWOMAN AND MEMBERS OF THE SUBCOMMITTEE:

On behalf of the over 2.9 million members of the Veterans of Foreign Wars of the United States and its Ladies Auxiliary, I wish to thank you for affording us this opportunity to speak here today with respect to the financial health and continued operation of the Veterans Administration Home Loan Guaranty Program. It is both a pleasure and a privilege to take part in this discussion on a program which has been so profoundly beneficial to both the nation and this nation's military veterans. As you know, the Veterans of Foreign Wars is firmly committed to working for the improvement of this program which is so important to all veterans and particularly at this time younger Vietnam veterans.

We must state from the outset that it is our heartfelt contention that the VA home loan program is first and foremost a veteran's entitlement program. As such, there should be absolutely no expectation that it always operate at a profit. That is simply not in the nature or spirit of entitlement programs. Entitlement programs very seldom deliver a profit, although through the majority of its existence, the VA home loan program has managed to serve this nation's veterans while operating in the black.

The VFW heartily applauds the efforts of the Senate and House Veterans' Affairs Committees on the formulation of the most comprehensive VA home loan program legislation to be enacted into law in recent history, Public Law 100-198, the "Veterans' Housing Rehabilitation and Program Improvements Act of 1987." We believe this law will contribute toward improving the operation and financial solvency of the VA home loan program.

Even so, due to certain unfortunate economic factors prevalent in the national economy, foreclosures and program costs are increasing. Many of the VA home loan program's problems are due to circumstances beyond its control; however, there is also room for improvement in its operation. With respect to reducing program cost there are, we believe, two main objectives to be achieved--reducing the number of foreclosures and improving the handling of defaulted properties by the VA.

With respect to reducing foreclosures, we believe veterans should be extended periods of grace and receive priority assistance from the VA in order to make their mortgage payments and keep their own homes. Both veterans and, ultimately, the VA Home Loan Guaranty Program would benefit.

We also believe considerable improvement can be made in the manner in which defaulted properties are handled. It is of paramount importance to reduce the amount of time real property is held by the VA. Real property is very expensive to hold since the VA must pay taxes on all such property in its inventory as well as securing it against vandalism and weather. Although the current decline in interest rates should increase VA property sales, new and more aggressive marketing techniques could further enhance such activity. Another means of enhancing the VA Home Loan Guaranty Program's assets would be increasing its portfolio of vendee loans--since they generate collections in the form of principle and interest payments. Additionally, funds generated by asset sales enter the Loan Guaranty Revolving Fund (LGRF) as offsetting collections which offset obligations and, correspondingly, outlays.

With respect to improving the operation and financial health of the VA Home Loan Guaranty Program, we will now address two provisions contained in S. 2049, legislation designed to improve the program's operation along with reducing its cost. The VFW is of the opinion that these two provisions should contribute toward the financial solvency of the program.

Section 2 of S. 2049 would establish an independent national commission to study the causes of increasing costs in foreclosures in the veteran's home loan guaranty program. The Commission would be comprised of nine individuals with demonstrated expertise in various areas and the Commission would be required to issue a report after one year with its findings and recommendations. The VFW supports this proposal.

Section 4 of S. 2049 would extend the credit worthiness requirements which are applied to VA guaranteed loans to VA vendee loans, as well. Inasmuch as this would be in the best interest of both the home loan program and involved veterans, we support this proposal. Certainly the very high incidence of default on VA vendee loans in itself warrants the application of credit worthiness requirements on individuals taking advantage of these loans.

Also under discussion today is the potential benefit of mortgage insurance versus the current one percent VA funding fee and then setting up an insurance pool which could be invested. It is a matter of record that the Veterans of Foreign Wars strongly opposes any increase in the user fee for VA guaranteed home loan. We further recognize that if this funding fee were replaced with mortgage insurance that the veteran would at least get something for his money. That is, if the veteran's loan were to go into default, mortgage insurance would afford a measure of financial protection. However, we would also point out that such insurance, even if subsidized in part by the government, would have to be paid year after year and could result in increased cost to the veteran. We are also concerned that such a program may have as yet unforeseen adverse implications for the program. So while we do not fully support this proposal at this time, we do acknowledge that further investigation is in order.

Also under discussion today is the possibility of renting certain foreclosed properties in economically depressed areas until such times as these dwellings can be sold at a better price. Once again, while readily acknowledging that this proposal may have merit, we must also express certain concerns and reservations. We ask whether the VA should become embroiled in the rental business. Along with creating the impression that the Veterans Administration is in direct competition with the private sector, we fear the VA may encounter severe difficulties in running and managing what would be a nationwide rental agency. Along with the problems and difficulties which are inherent in any such operation, we would also point out that it will be more difficult to operate a rental program targeted on economically depressed areas. High maintenance costs and the fact that the incidence of rent in arrear is often much higher in such areas are all factors. It is a distinct possibility that consequent legal actions and adverse publicity associated with the VA serving as a giant federal landlord could finally do more harm than good. Once again, however, we do believe that this proposal merits further investigation.

Although not specifically scheduled for discussion today, we would like to take this opportunity to state our position on an issue which has severe consequences for the VA home loan program and this nation's veterans. I am speaking of the Administration's proposed credit subsidy legislation. This so-called credit reform proposal embraces estimating the grant equivalent subsidy value of federal credit programs and, in case of the Veterans Administration, would require appropriations of approximately $1.1 billion in FY 1989.

This proposal initially surfaced last year in the form of legislation, S. 745, and amendments to the President's FY 1988 Budget. Essentially, this proposal would require estimating and reporting the subsidy costs of new credit activity in individual agency budget accounts. Under this proposal the VA would be mandated to request annual appropriations equal to the amount of subsidy estimated to be provided to borrowers receiving VA home loan guaranty mortgages and vendee loans during each fiscal year. The proposal requires subsidy payments to a central revolving fund at the Treasury prior to making a loan. The agency will continue to administer the program, but the Treasury will be the central finance mechanism for new Federal loans. The Administration estimates the subsidy value for guaranteed loans to be 6.6 percent in 1989 and 16 percent for vendee (direct) loans.

The subsidy appropriations would be to a new budget account--a companion of the VA Home Loan Guaranty Revolving Fund--and would involve budget authority and outlays in the same manner as direct spending programs. When loans guaranteed under the home loan guaranty program were dispersed or property exchanged for vendee loan mortgages, the VA would use these appropriations to pay the estimated subsidy costs of the transactions to a new central revolving fund in the Treasury. The Veterans of Foreign Wars adamantly opposes this proposal since it would restrict the VA home loan program's operation and subject veterans to undue hardship.

One must not lose sight of the fact that the government provides a subsidy to a borrower only by incurring an equivalent loss. Along with the general expense inherent to operating the loan guaranty program, the major cause of "equivalent loss"--of losing money--to the program fund is when loans go into default. Thus, this so-called credit reform proposal would call for an appropriation of actual dollars to be set aside to cover an estimated loss which may never be realized, that is, the estimated number of loans may well not go into default. The VA would be prevented from utilizing scarce appropriation dollars for the sake of responding to chimerical paper losses. As an illustrative point, we would mention that had this credit reform proposal been in effect during the many years that the VA home loan program operated at a small profit, appropriations still would have been necessary, to pay for a nonexistent Federal subsidy.

Another obvious flaw in this proposal is that such an appropriation would restrict the number of loans the VA could make in a given fiscal year. Given that an actual appropriation would be required to counter potential or paper losses, once the loan appropriation is used up, the timely enactment of necessary supplemental appropriation would be unlikely. Indeed, in these troubled fiscal times, the likelihood of the Congress approving any supplemental appropriation at all is dubious. Thus, untold deserving veterans would be prevented from obtaining a VA loan and the VA loan program itself would suffer because origination fees that would have been paid on new loans would not be realized. The VA loan program would also suffer because its much needed vendee loan activity would be stopped dead in its tracks. The VA would lose profits and the critical rebuilding of the vendee loan portfolio would also be halted. This would also be highly detrimental to the banking and building industries is evident. Thus, this credit reform scheme harbors disastrous consequences for the veteran, the VA loan program and the nation.

We will also comment at this time on legislation which is being proposed to repeal the Administrator's authority to establish maximum interest rates. The Veterans of Foreign Wars strongly opposes eliminating the Administrator of Veterans' Affair's current authority to establish the VA home loan interest rate. We view the often posited argument that this authority limits a veteran's ability to negotiate a more favorable rate as specious. The VA established rate is, in fact, only a ceiling which certainly does not disallow a veteran and a lending institution from negotiating a lower mortgage rate. The VA established rate not only provides the veteran with greater parity in an unequal market place, it also serves as a national benchmark providing both the mortgage and the building industries with a degree of stability that they would not otherwise enjoy. We are convinced that eliminating the Administrator's authority to establish an interest ceiling would be a serious mistake, working against the veteran's best interest and seriously jeopardizing a most beneficial program.

Madam Chairwoman, this concludes my testimony. Once again on behalf of the Veterans of Foreign Wars of the United States, I wish to express our thanks to you and the other members of the Subcommittee for holding this important hearing. I will be happy to respond to any questions you may have. Current VFW Resolution Number 617 which pertains to the VA home loan program is appended to this statement.

THE NON COMMISSIONED OFFICERS ASSOCIATION OF THE UNITED STATES OF AMERICA

"STRENGTH IN UNITY"

Statement of

Richard W. Johnson, Jr.
Director of Legislative Affairs

before the

Subcommittee on Housing and Memorial Affairs
Committee on Veterans Affairs
U.S. House of Representatives

on the

Veterans Administration
Home Loan Guaranty Program

March 17, 1988

NATIONAL CAPITAL OFFICE
225 N. Washington Street • Alexandria, VA 22314 • Tele: (703) 549-0311

Thank you for once again inviting the Non Commissioned Officers Association of the USA (NCOA) to comment on the Veterans Administration Home Loan Guaranty program. Hopefully the committee will find the comments and recommendations contained herein useful in setting the program and the Loan Guaranty Revolving Fund (LGRF) on a course of economic recovery that will make it both affordable and viable in the years ahead.

Benefit Program

NCOA continues to view the Home Loan Guaranty Program as a benefit program made available to veterans by a nation grateful for their service. It was under this concept that the program was first established. The program goals have remained unchanged: Assist the veteran in the purchase of a home; assist the veteran in retaining the home; and, manage the program to minimize its cost. Overall, the program is a magnificient success. It has made possible homeownership for more than 12 million veterans and it has added nearly $300 billion in property to the tax bases of comunities across the nation. The program was so successful that it became self sufficient using the income from direct and vender loans to offset the losses suffered on acquisitions and foreclosures. Whether as a result of good management or good fortune this success obviated the need for appropriations to the LGRF until 1984.

Unfortunately the early financial success of the program has somewhat eroded and distorted its perception as a benefit program. Herein lies the most important key to program restoration.

As a benefit program loan guaranty can be expected to cost money.

Congress must reconcile itself to this fact. If it does not, only further problems will result.

Cost transfer

Over the past few years, Congress and the Administration have lost sight of the benefit aspect of loan guaranty. Instead both have focused on the historical self sufficiency of the program to presume it should have no cost. As the needs for appropriations began to arise, congress and the administration sought solutions to reduce outlays. Too often these costs were transferred to veterans.

First came the creation of the temporary one half of one percent funding fee. Then came proposals to increase the fees, finally successful in creating a "permanent" one percent funding fee. As detestable as the fee is, at least it is honest and overt. More covertly, other program costs have been transferred to veterans.

The funding fee was supposed to offset the cost of foreclosures and reduce the debt of less fortunate veterans whose homes are lost. Yet by provision of the Budget Reconciliation Act of 1984 (P.L.98-369 section 2512), the VA automatically takes 10.75 percent of the value of any home in foreclosure for acquisition, management and resale expenses. Under this "net value" formula, veterans who paid funding fees for their own guaranty, expecting protection against such loss, are legally robbed of profit potential in foreclosure. (Examples are attached) The "no bid" formula further transferred program costs to veterans. New underwriting criteria transfer costs to veterans. Indeed, as NCOA has warned, these transfers are making the program a "veterans helping veterans" program more than a federal benefit program for veterans.

Insurance Alternative

Creating a mortgage insurance program would further

exacerbate the problem. Foremost, such a program has no potential to produce well managed self sufficiency. Without commercial trading experience, its cost could and most likely would exceed the subsidy value of the current guaranty. Moreover, it like many of the changes in the program over the past few years, would transfer more of the program cost to veteran participants.

There is nothing basically wrong with the VA loan guaranty program. Its structure is sound. Its benefits are significant to both the veteran and the nation.

Creating a new insurance program will cost money, probably substantially more than it will cost to buy solvency in the LGRF. It is not just a matter of creating a new program and funding the benefit. Two thousand employees must be retrained or replaced, computer systems, hardware, software, accounting systems must be invented. And, once completed, the program will still require perpetual appropriations. In the absence of reliable data to the contrary, NCOA believes a few changes in the LGRF together with the appropriations necessary to create an insurance program could buy near perpetual solvency in the LGRF.

Loan Guaranty

Its no secret that the elimination of the VA's direct loan program and the sale of portfolio assets has led to the current need for appropriations to the LGRF. The sale of loan assets was begun in the 1970's at the insistence of the Office of Management and Budget (OMB). The reason was a simple, perhaps even innocent, belief that surpluses in the fund could be used to reduce the requests for budget authority and outlays in other programs. In other words, assets were liquidated to reduce the deficit and to make OMB spread sheets look good. Yet OMB ignored one of the basic laws of economics. Assets are a limited resource, thus OMB sold the future of the program.

Even this might have been a tolerable mistake but for a recession that resulted in an unprecedented increase in foreclosures. Then follow the recession with a period of highly volatile interest rates and an unprecedented demand for new guarantees. The combined economic effect could not be quietly overcome.

Once the mistake became apparent, only short term solutions were considered. Previously discussed fees were created, the "no bid" and "net value" formulas were established. Underwriting criteria on new loans and assumptions were changed. On the other side: more attention was given to curing defaults and helping veterans retain their homes. With the failure of these efforts came the auctions and more portfolio sales.

Loan Sales and Interest

Asset sales that are ongoing now are almost criminal from a policy and management standpoint. They are a manifestation of the current administration's obsessive facination with divestiture and privatization.

This year the Administration has once again proposed negotiated rates for VA loans, the without recourse sale of loans ($780.7 million net in 1989) and a divestiture of $861 million in portfolio assets. NCOA continues to oppose negotiated rates. Such an action would be a gift to mortgage lenders and could increase the exposure of the VA on defaults since guaranty payments are in part based on accumulated interest from time of default. It should also be remembered that fixed VA interest rates are the only benchmark by which both lenders and homebuyers can measure rate competitiveness.

Without recourse loan sales, and, in fact, loan sales in general are a bad idea. The Administration insists on such sales

for two reasons. Foremost, there is a desire to produce short term income. Second, the privatization obsession dictates that profit making enterprises should be sold to private industry. Such logic is misguided at best.

Such sales and divestiture from a government perspective mean only the sale of self-sufficiency in the program. The VA recently announced it had sold $219.3 million in loans for $220.5 million. The margin by measure was .54 percent above par. The monthly income from those loans averaged .79 percent. In other words the VA sold a thirty-year monthly income of more than $1.5 million for a one time profit of profit of $1.2 million. Such a sale might make some modicum of sense in private industry if the profit were rolled into an income producing investment, but it hardly makes sense to government. Such sales and divestiture from a government perspective mean only the sale of self-sufficiency in the program.

In testimony before this committee last year a representative from CBO testified most eloquently about the long term value of loan sales.

> . . .CBO believes that reductions in the budget deficit, properly measured, should only reflect actions that actually improve the government's financial condition and, thus, lessen the need to reduce spending or increase tax revenues now or in the future. Since sales of VA vendee loan and other loan assets, with or without recourse to the government, do not improve the government's financial condition CBO believes they should not be considered to reduce the deficit. The cash the government receives in exchange for loan assets sold without recourse does indeed reduce the current cash deficit, federal borrowing, and future interest payments on the federal debt. Nonetheless, future deficits and borrowing will not be reduced because the interest and principal payments will go to the loan asset holder, rather than the government, and these amounts are equivalent in present value terms to the

> proceeds of the sales. Moreover agency loan sales do not reduce the government's demands on the credit market--the Treasury borrows less, but the sales tap the same pool of saving. Thus, in CBO's view, loan sales--with or without recourse--are merely a more expensive form of borrowing than issuing Treasury debt, and should not be considered a form of deficit reduction because they do not improve the government's financial condition.

Accordingly NCOA must believe that the most promising use of resources rests in acquisition and management of a sound VA portfolio of loans.

Policy and Rebuilding

To successfully reacquire a portfolio capable of producing income sufficient to support the loan guaranty program will take some time. A statement of this goal should be made in law with sufficient force to preclude OMB interference. CBO should be required to assess the issue and make recommendations on how large a VA portfolio should be to meet the liabilities of the fund at several levels. For example: should the portfolio be sufficient in size to eliminate the need for appropriations or should the portfolio be such that it would not meet the extreme demands of a recession.

At the same time the VA must be prepared for portfolio management. Some automation will be required to manage a portfolio and the VA would probably benefit from experienced talent in managing a larger system.

New accounting procedures would also benefit the program. The LGRF should be switched from its annual cash basis system to one which more accurately reflects the income, holdings and expenses of the fund. Such accounting would allow Congress and other observers to better assess the needs of the program.

Finally, consideration should be given to reopening the direct loan program. While NCOA understands the desirability of not competing with civilian lenders necessary to the success of the program, the association believes such lenders would be understanding about the need to preserve and rebuild the program. In the long run it would be in the best interest of all mortgage lenders to preserve the VA program.

Property Inventory

The VA's property inventory can be an asset in rebuilding the VA portfolio. It is indeed, the most readily available asset convertible to long term income. However, some innovation might be necessary to convert these properties to portfolio loans. The VA should be allowed and encouraged to hold properties which can not be readily sold. Some should be leased if possible to reduce vandalism and neglect. Others should be retained until profitable sale is possible. No homes should be auctioned out of frustration after as little as three months in the inventory as is being done now.

Conclusion

NCOA believes that congress should begin a reinvestment in the home loan guaranty program. Such a reinvestment could bring about changes to restore self sufficiency in the LGRF. The association is also convinced that this will be the least expensive option to preserving the loan guaranty program. NCOA also asks congress to repeat the "net value" provision of public law 98-369.

-end-

Calculating the Veteran's Debt When a GI Loan is Terminated

Under the present law, VA determines the net value of a property to the Government prior to termination of the loan. Normally, the loan holder is required to credit the total due on the loan account with this net value. VA then pays the holder a claim under the guaranty for the remaining balance of the debt and establishes a corresponding liability account against the veteran. In some cases, where a maximum claim would be payable, the holder is not required to credit the loan account with any specific property value.

If the veteran were given credit for the full market value of the property at foreclosure, rather than the net value of the property to the Government, the amount of his or her eventual liability could be reduced or eliminated. Three examples are attached which show the difference in debt computation between these two procedures.

It should be noted that implementation of this change would not amend the existing procedures for determining net value, determining whether loan holders have the option to convey property to the Government, or determining the amounts VA will pay for claims and property acquisition. Giving the veteran credit for the full current fair market value of his or her property would only amend VA's internal procedures for computing the amount of debt to be established against the veteran.

Veterans Administration

SUMMARY OF BASIS FOR LIQUIDATION PROCEDURE

NOTE: This form will be used in connection with a determination of whether or not to specify an amount under 38 CFR 36.4320, and all liquidations of acquired, vendee, or direct loans.

1. NAME OF HOLDER		2. NAME OF VETERAN	
3. LOAN NUMBER	4. TYPE OF LOAN ☐ GI ☐ VENDEE ☐ DIRECT ☐ ACQUIRED	5. REGIONAL OFFICE	6. DATE 12/30/87
7. PROPERTY OCCUPIED BY ☐ ORIGINAL VETERAN ☐ TRANSFEREE ☐ TENANT ☐ VACANT		8. NAME OF PRESENT OWNER (If different than Item 2)	

ITEM NO.	ITEM	DATE	AMOUNT
9.	PRIMARY MORTGAGE INDEBTEDNESS, IF ANY, AS OF DATE OF LIQUIDATION		
10.	GUARANTEED OR INSURED INDEBTEDNESS AS OF DATE OF LIQUIDATION	1/22/88	74,500
11.	UNPAID TAXES, SPECIAL ASSESSMENTS, GROUND RENTS OR OTHER LIENS WHICH WILL BE PAID BY HOLDER PRIOR TO FORECLOSURE OR DEDUCTED FROM SALES PROCEEDS		
12.	ESTIMATED COSTS OF FORECLOSURE (Not included in Items 9 or 10)		500
13.	ESTIMATED INDEBTEDNESS AT LIQUIDATION (Item 9 or 10 plus Items 11 and 12)		75,000
14.	CLAIM PAID OR PAYABLE		27,500
15.	BALANCE DUE HOLDER (Item 13 less 14)		47,500

ITEM NO.	ITEM	DATE	AMOUNT
16.	ORIGINAL REASONABLE VALUE	1/1/83	65,000
17.	LATEST REASONABLE VALUE "AS IS"	12/15/87	76,000
18.	LATEST REASONABLE VALUE "AS REPAIRED" AT AN ESTIMATED COST OF $		
19.	ESTIMATED VA EXPENSE FOR ACQUISITION, MANAGEMENT AND RESALE AT 10.75 %		8,170
20.	ESTIMATED NET VALUE OF PROPERTY TO VA (Item 17 less 19 or 18 less 19, and cost of repairs)		67,830
21.	☒ SPECIFIED AMOUNT ☐ MAXIMUM BID		67,830

22. SIGNATURE OF CHIEF, LOAN SERVICE AND CLAIMS SECTION	23. SIGNATURE OF CHIEF, APPRAISAL SECTION
24. SIGNATURE OF CHIEF, PROPERTY MANAGEMENT SECTION	25. SIGNATURE OF LOAN GUARANTY OFFICER

26. REMARKS (Use reverse if additional space is needed)

EXAMPLE 1

SPECIFIED AMOUNT

In this example, the total due on the loan account at foreclosure is $75,000 (line 13) and the market value of the property is $76,000 (line 17). Following procedures currently in effect, the market value was reduced by 10.75% (this percentage represents VA's estimated costs for management, acquisition and disposition of the property in 1987) to arrive at a net value of $67,830.

The loan holder will be required to credit the veteran's debt with the $67,830 and VA will pay a claim for the difference ($75,000 - $67,830 = $7,170). A corresponding debt of $7,170 would be established against the veteran.

If the veteran were given credit for the full market value of the property, however, in computing the veteran's debt to the Government, the full value of $76,000 would exceed the total due on the loan ($75,000), and there would be no claim payable and no debt established against the veteran.

INSTRUCTIONS: See Chapter 2, M26-4.

VA FORM [illegible] SUPERSEDES VA FORM 26-8312, MAR 1983

Veterans Administration

SUMMARY OF BASIS FOR LIQUIDATION PROCEDURE

NOTE: This form will be used in connection with a determination of whether or not to specify an amount under 38 CFR 36.4320, and all liquidations of acquired, vendee, or direct loans.

1. NAME OF HOLDER		2. NAME OF VETERAN	
3. LOAN NUMBER	4. TYPE OF LOAN ☐ GI ☐ VENDEE ☐ DIRECT ☐ ACQUIRED	5. REGIONAL OFFICE	6. DATE 12/30/87
7. PROPERTY OCCUPIED BY ☐ ORIGINAL VETERAN ☐ TRANSFEREE ☐ TENANT ☐ VACANT		8. NAME OF PRESENT OWNER (If different than Item 2)	

ITEM NO.	ITEM	DATE	AMOUNT	ITEM NO.	ITEM	DATE	AMOUNT
9.	PRIMARY MORTGAGE INDEBTEDNESS, IF ANY, AS OF DATE OF LIQUIDATION			16.	ORIGINAL REASONABLE VALUE	1/1/81	65,000
10.	GUARANTEED OR INSURED INDEBTEDNESS AS OF DATE OF LIQUIDATION	1/20/88	74,500	17.	LATEST REASONABLE VALUE "AS IS"	12/15/87	70,000
11.	UNPAID TAXES, SPECIAL ASSESSMENTS, GROUND RENTS OR OTHER LIENS WHICH WILL BE PAID BY HOLDER PRIOR TO FORECLOSURE OR DEDUCTED FROM SALES PROCEEDS			18.	LATEST REASONABLE VALUE "AS REPAIRED" AT AN ESTIMATED COST OF $		
12.	ESTIMATED COSTS OF FORECLOSURE (Not included in Items 9 or 10)		500	19.	ESTIMATED VA EXPENSE FOR ACQUISITION, MANAGEMENT AND RESALE AT 10.75 %		7,525
13.	ESTIMATED INDEBTEDNESS AT LIQUIDATION (Item 9 or 10 plus Items 11 and 12)		75,000	20.	ESTIMATED NET VALUE OF PROPERTY TO VA (Item 17 less 19 or 18 less 19, and cost of repairs)		62,475
14.	CLAIM PAID OR PAYABLE		27,500				
15.	BALANCE DUE HOLDER (Item 13 less 14)		47,500	21.	☒ SPECIFIED AMOUNT ☐ MAXIMUM BID		62,475

22. SIGNATURE OF CHIEF, LOAN SERVICE AND CLAIMS SECTION	23. SIGNATURE OF CHIEF, APPRAISAL SECTION
24. SIGNATURE OF CHIEF, PROPERTY MANAGEMENT SECTION	25. SIGNATURE OF LOAN GUARANTY OFFICER

26. REMARKS (Use reverse if additional space is needed)

EXAMPLE 2 — SPECIFIED AMOUNT

In the example, the total due on the loan account at foreclosure is $75,000 (line 13) and the market value of the property is $70,000 (line 17). Following procedures currently in effect, the market value was reduced by 10.75% (this percentage represents VA's estimated costs for management, acquisition and disposition of the property in 1987) to arrive at a net value of $62,475.

The loan holder will be required to credit the veteran's debt with the $62,475 and VA will pay a claim for the difference ($75,000 - $62,475 = $12,525). A corresponding debt of $12,525 would be established against the veteran.

If the veteran were given credit for the full market value of the property, however, in computing the veteran's debt to the Government, the loan balance would be credited with the full value of $70,000 and a liability account would be set up for only $5,000 ($75,000 - $70,000 = $5,000).

INSTRUCTIONS: See Chapter 2, M26-4.

Veterans Administration

SUMMARY OF BASIS FOR LIQUIDATION PROCEDURE

NOTE: This form will be used in connection with a determination of whether or not to specify an amount under 38 CFR 36.4320, and all liquidations of acquired, vendee, or direct loans.

1. NAME OF HOLDER		2. NAME OF VETERAN	
3. LOAN NUMBER	4. TYPE OF LOAN ☐ GI ☐ VENDEE ☐ DIRECT ☐ ACQUIRED	5. REGIONAL OFFICE	6. DATE 12/30/87
7. PROPERTY OCCUPIED BY ☐ ORIGINAL VETERAN ☐ TRANSFEREE ☐ TENANT ☐ VACANT		8. NAME OF PRESENT OWNER (If different than Item 2)	

ITEM NO.	ITEM	DATE	AMOUNT
9.	PRIMARY MORTGAGE INDEBTEDNESS, IF ANY, AS OF DATE OF LIQUIDATION		
10.	GUARANTEED OR INSURED INDEBTEDNESS AS OF DATE OF LIQUIDATION	1/22/88	74,500
11.	UNPAID TAXES, SPECIAL ASSESSMENTS, GROUND RENTS OR OTHER LIENS WHICH WILL BE PAID BY HOLDER PRIOR TO FORECLOSURE OR DEDUCTED FROM SALES PROCEEDS		
12.	ESTIMATED COSTS OF FORECLOSURE (Misc included in Items 9 or 10)		500
13.	ESTIMATED INDEBTEDNESS AT LIQUIDATION (Item 9 or 10 plus Items 11 and 12)		75,000
14.	CLAIM PAID OR PAYABLE		27,500
15.	BALANCE DUE HOLDER (Item 13 less 14)		47,500

ITEM NO.	ITEM	DATE	AMOUNT
16.	ORIGINAL REASONABLE VALUE	1/1/83	65,000
17.	LATEST REASONABLE VALUE "AS IS"	12/15/87	50,000
18.	LATEST REASONABLE VALUE "AS REPAIRED" AT AN ESTIMATED COST OF $		
19.	ESTIMATED VA EXPENSE FOR ACQUISITION, MANAGEMENT AND RESALE AT 10.75%		5,375
20.	ESTIMATED NET VALUE OF PROPERTY TO VA (Item 17 less 19 or 18 less 19, and cost of repairs)		44,625
21.	☐ SPECIFIED AMOUNT ☐ MAXIMUM BID		None

22. SIGNATURE OF CHIEF, LOAN SERVICE AND CLAIMS SECTION	23. SIGNATURE OF CHIEF, APPRAISAL SECTION
24. SIGNATURE OF CHIEF, PROPERTY MANAGEMENT SECTION	25. SIGNATURE OF LOAN GUARANTY OFFICER

26. REMARKS (Use reverse if additional space is needed)

EXAMPLE 3

NO AMOUNT SPECIFIED (NO-BID)

In this example the total due on the loan account at foreclosure is $75,000 (line 13) and the market value of the property is $50,000 (line 17). Following procedures currently in effect, the market value was reduced by 10.75% (this percentage represents VA's estimated costs for management, acquisition and disposition of the property in 1987) to arrive at a net value of $44,625.

The unguaranteed portion of the debt ($47,500) exceeds the net value of the property ($44,625). There would be no advantage to VA in purchasing the property since this would not result in any reduction in the claim payable ($27,500). The veteran's debt is the amount of the claim, $27,500.

If the veteran were given credit for the full market value of the property, however, in computing the veteran's debt to the Government, the loan balance would be credited with the full value of $50,000 and a liability account would be set up for only $20,375 ($75,000 - $44,625 = $20,375).

INSTRUCTIONS: See Chapter 2, M26-4

STATEMENT OF
JOHN C. BOLLINGER, ASSOCIATE LEGISLATIVE DIRECTOR
PARALYZED VETERANS OF AMERICA
BEFORE THE
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
OF THE
HOUSE COMMITTEE ON VETERANS' AFFAIRS
CONCERNING THE VA LOAN GUARANTY PROGRAM
MARCH 17, 1988

Ms. Chairwoman and Members of the Subcommittee, I am John Bollinger, Associate Legislative Director of the Paralyzed Veterans of America, and on behalf of the members of PVA, I wish to thank you for conducting this hearing on the VA Loan Guaranty Program. We appreciate the opportunity to express our views regarding the solvency of the program and to convey our concerns regarding the future of the program as it relates to several proposed legislative changes to be submitted by the Administration.

Initially, PVA thanks all Subcommittee Members for their efforts in 1987 to pass legislation which resulted in Public Law 100-198. This law, as you know, increased loan guarantees and brought the maximum guaranty in line with current housing costs which have risen so dramatically over the years. On behalf of our members, we thank you.

ADMINISTRATION'S PROPOSAL TO REPEAL MAXIMUM INTEREST RATES

Our first area of concern involves the Administration's proposal, once again, to repeal the VA's current authority to set the maximum interest rates at which lenders can make guaranteed loans. This legislation would allow that loans guaranteed or insured under Chapter 37 of title 38 be payable on such terms and conditions as may be agreed upon by the veteran and the lender. These negotiated rates would bear such interest for the lifetime of the loan. As the House Committee on Veterans' Affairs' report to the Committee on the Budget, March 10, 1988, so clearly points out, such loans would have several adverse effects on the VA Loan Program and the veterans utilizing it. We agree that veterans would end up paying higher interest rates which would result in the erosion of their purchasing power. These rates would translate into higher mortgage payments and would ultimately have an adverse effect on the Loan Guaranty Revolving Fund.

In addition to the points expressed in the March 10 report, we are concerned that if the Administration's proposal of negotiated interest rates were implemented, the "no down payment" feature of the VA Home Loan Guaranty Program would be jeopardized. Since the inception of the Home Loan program over forty years ago, the dream of home ownership has been made possible, primarily, because veterans and service personnel were not forced to liquidate their life savings in order to make the down payment on a home.

PVA believes that in order for a veteran to negotiate and secure a favorable interest rate, it quite possibly would be necessary for the veteran to make a sizable down payment, thereby removing one of the most advantageous features of the program. Such a proposal would remove the incentive for veterans to participate in the program. It would also place the veteran borrower in a situation where he would have to seek out favorable terms and be forced by lenders to accept above market rates.

CREDIT SUBSIDY LEGISLATION

Our second area of concern involves the Administration's legislative proposal on credit subsidy. We oppose this initiative for three reasons. First, we feel the VA could potentially lose substantial control of a program that is rightfully within the complete jurisdiction of the VA Home Loan Guaranty Program. In order to maintain the integrity of the VA's guaranteed loans, we strongly oppose any effort to diminish the VA's role in their own program by

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placing the control financing mechanism, side by side, with all other new federal loans under the jurisdiction of the Treasury.

Second, the Administration's proposal states that subsidy amounts will serve as ceilings on the volume of new credit that may be offered by the account. We are concerned that the traditional source of funding may not continue to be available to finance the program and that the true motivation behind the legislation is to limit the number of loans the VA can guaranty.

Third, we question the fiscal soundness of this proposal. The legislation requires, in Fiscal Year 1989, that a grant equivalent subsidy of 6.6 percent ($1.3 billion) be deposited in a Treasury account whether or not the money is actually ever needed. As regional problems affecting the Loan Guaranty Revolving Fund are addressed by Congress and the number of foreclosures begins to decrease (historically, only five percent of VA loans go to foreclosure), it is questionable whether this credit subsidy, in a time when we are trying to reduce the federal deficit, represents money wisely invested.

GENERAL OPERATING EXPENSES/LOAN GUARANTY FTEE

Our third area of concern is the Administration's proposal to reduce Loan Guaranty staffing by 75 FTEE. At a time when the program is experiencing critical shortages of experienced staff to handle both record numbers of new guarantees and significant regional foreclosure problems, additional staff reductions will have a crippling affect on the ability of the program to even minimally carry out their mission. We strongly support all efforts to restore funding to the General Operating Expense for these desperately needed FTEE's.

In regard to improvements and innovations in the VA Home Loan Guaranty Program, PVA has several recommendations. First, as we have stated in our Independent Budget, an accurate estimate of the needs for the VA's Loan Guaranty Revolving Fund is difficult to ascertain. A significant part of the problem is due to economic and market conditions that are extremely adverse in certain areas of the country. We urge the Congress to fully address the programmatic and financial problems of the fund. This Subcommittee's intent to explore the benefits of mortgage insurance, the establishment of an insurance pool that could be invested, and other innovations is precisely the kind of program evaluation we need.

Second, we recommend that Congress increase the number of direct loans the VA is authorized to make to eligible veterans. Prior to 1980, the VA direct home loan program produced significant income for the revolving fund. We believe this represents a fiscally responsible initiative to ensure the long term security of the VA Home Loan Program.

Finally, although we applaud the December appropriation which furnished additional monies for counseling assistance to help delinquent borrowers retain ownership of their homes, we feel additional efforts must be made to avoid foreclosures in the first place. Obviously, both money and staffing are necessary ingredients. Again, we emphasize our concern that the Administration's 1989 Budget request calls for 75 fewer loan guaranty personnel.

In conclusion, although long range solvency is a priority, PVA stresses the fact that VA guaranteed home loans are, in fact, benefits for veterans. The intent of Chapter 37, Title 38, is to provide a certain degree of protection for the veteran home buyer and to enable the veteran to purchase a home with a degree of financial advantage. In our effort to provide long term solvency, we must not trade off veterans' benefits in favor of provisions that would benefit the mortgage company or lender.

PVA wishes to thank the Subcommittee for the opportunity to present our views and comments on the VA Loan Guaranty Program. We look forward to working with the Committees in Congress to assure that this vital program remains solvent and continues to make home ownership a reality for millions of our Nation's veterans. That concludes my testimony, and I will attempt to answer any questions you might have.

STATEMENT OF

VIETNAM VETERANS OF AMERICA

Presented By

PAUL S. EGAN
LEGISLATIVE DIRECTOR

before the

HOUSE VETERANS AFFAIRS SUBCOMMITTEE
ON HOUSING AND MEMORIAL AFFAIRS

on

RESTORING SOLVENCY TO THE VA'S HOME LOAN GUARANTY REVOLVING FUND

MARCH 17, 1987

Madam Chairwoman and members of the subcommittee, the Vietnam Veterans of America, Inc. appreciates this opportunity to present its views on the VA's home loan guaranty program. This hearing is both timely and necessary given the dire fiscal straights facing this extremely important program. For the nation's youngest generation of war time veterans, veterans having reached the prime home-buying age, this program is quintessentially significant. Problems with this particular program that threaten its viability as a tool to assist veterans, especially first time home-buying veterans, must be taken seriously and corrected in the speediest, most efficient possible manner.

The problems facing this program are serious ones. They are problems of physical stability, marketing and management. Each is urgent, yet in the last several years that each of these problems has emerged and persisted the VA has failed to properly adjust. The net result is a general worsening of conditions that may soon give a normally sympathetic Congress pause to wonder whether the program's goals are worth the cost.

The Fiscal Year 1989 budget submission proposes a reduction in FTEE for the loan guaranty program of 75. This comes on the heels of a 25 FTEE loss in Fiscal Year 1988, leaving a projected total FTEE of 2025. To cover shortages in the Loan Guaranty Revolving Fund (LGRF), $658 million has been requested for Fiscal Year 1989. Just last December $389 million in appropriations for the LGRF was approved for Fiscal Year 1988 and now we learn that even this is insufficient. Unless another $526.6 million in supplemental appropriations for the current fiscal year are approved by mid to late March, the program will begin to default on its obligations.

Much of the need for added infusions of scarce taxpayer resources is due to high foreclosure rates that have bloated the VA's inventory of foreclosed properties from 8,977 in 1980 to 22,584 by the end of Fiscal Year 1987. Another significant reason for the need to inject large sums of new resources is the VA's failure to market the properties in its inventory at less than fire sale prices in a timely manner. The single perhaps most

important reason for the need to add new appropriations stems from an ill conceived policy begun in 1981 to sell off the program's principal source of income, its home loan portfolio.

This year it is again proposed that this policy continue. It is specifically proposed that the balance of $561 million in the VA's home loan portfolio be liquidated in Fiscal Year 1989. This would follow projected sales of $300 million in portfolio loans in the current fiscal year.

Each of these policies, that of reducing FTEE, failing to properly market foreclosed property and selling off its income-generating home loan portfolio, has proven to be disastrous to the loan guaranty program. Adding insult to injury, the Fiscal Year 1989 budget submission also proposes a policy boding poorly for the very veterans the program was designed to assist. This is the policy of requiring veterans to negotiate their own mortgage interest rates with individual lenders rather than retaining an administratively set maximum interest rate applying to all VA guaranteed mortgages nation wide. This proposal was discussed and rejected when it first surfaced in last year's budget submission because it became widely understood that most first time home buyers are often ill equipped to negotiate on an equal footing with professional bidders. This inadequacy would likely result in higher interest rates and possible downpayments depending on development of future accepted practices by lenders in many regions of the country.

Moreover, the problems with the program are real and need solving as quickly as possible. In the Senate, legislation has been introduced, S.2049, which in part is designed to establish a national commission to survey the home loan program and report to the Congress on possible solutions. The VVA has supported this concept but has cautioned that the commission not be top heavy with appointees with a vested financial interest in the proposed solutions to the home loan guaranty program's problems. Instead, we have suggested greater representation by the veterans' consumer advocates. This suggestion has been made with the understanding that the

program is a veterans benefit program first and foremost. Any solutions proposed and/or implemented must be tempered by the fact that this is not a banker's, builder's, realtor's or mortgage backed security broker's program.

Apart from the Senate legislation, and apart from the VVA's expressed support for its approach, something must be done much sooner. To await the conclusions of a commission would require a delay of at least a year and a half. Whether the taxpayers would retain their support for this program in the interim by continuing to allocate resources to an insolvent LGRF is an open question. In any event, the VVA is unwilling to risk a delay of this duration. It is well to establish a commission as contemplated in the Senate legislation, but that alone will constitute insufficient remedial relief in the short term.

Madam Chairwoman, last year's legislation that you authored to reform the program, which was subsequently enacted as P.L. 100-198, was forward-looking and may yet be shown to solve many of VA's home loan guaranty problems. We shall have to wait and see how effectively the VA implements the new law's many positive provisions. If they are improperly or only half-heartedly implemented, it will be a signal that the VA is either insistent upon pursuing a business-as-usual course or it is following instructions, perhaps from the OMB, to erode the program through emasculation.

With regard to the latter proposition, it has become clear that this Administration wants the federal government out of the credit market. Another of this year's budget proposals would transfer the VA's credit activity to the Department of the Treasury. Appropriations for this new credit reform proposal amounting to $1.3 billion are requested to support some $17.9 billion worth of VA home loan guarantees. Each time a guaranty is provided under the proposal, the dollar value of the guaranty would be transferred to the Treasury Department. If the VA exhausted its appropriations for this purpose, loan guaranty activity would cease unless further appropriations were allocated. It seems simple enough to imagine, on the

basis of this Administration's record, that the exhaustion of guaranty appropriations is precisely what is intended.

Another example of what we believe to be this administration's underlying agenda for the home loan program involves this year's budget request proposal to reduce the home loan guaranty program's staff levels by 75 FTEE. Last year's legislation authorized the VA to offer counseling to veterans whose homes are in default. In order to implement this provision of law designed to reduce the numbers of foreclosures, it will require more rather than less FTEE. Similarly, the VA cannot be expected to aggresively market its inventory of foreclosed properties, even if it were disposed to do so, with less rather than more FTEE.

In your letter of invitation we were invited to offer suggestions on how the LGRF might be restored to solvency. The letter itself offered a few suggestions very worthy of comment. The idea of applying the one percent user fee-generated funds for mortgage insurance is appealing. Currently, the veteran paying the user fee gets nothing for the investment. To use this for mortgage insurance instead would at least allow for the purchase of something of value, in this case protection against default. Under no circumstances, however, should there be a conversion from a guaranty-based program to a mortgage insurance-based program. Before fully endorsing this proposal, we would like to be advised as to the level of protection that would be provided and under what circumstances it would and would not become available. Another question we have about this proposal is, who would operate the insurance program; would it be the VA or the private sector?

Another proposal in the letter of invitation to this morning's hearings would authorize the renting of foreclosed property in the VA's inventory until such time as the property is sold. The VVA is inclined to oppose this idea because it would either make the VA itself a landlord or it would allow the VA to contract out the management of its rented property. In the first instance, the VA as a landlord would likely become an agency public relations nightmare. One can readily imagine the stories on televised local

evening news programs where the VA is featured evicting delinquent tenants and their families with no place to go but the nearest homeless shelter. Apart from this, the VA has neither the personnel nor the fiscal resources to manage such a program.

In the second instance, the VA's experience to date with contracting for the management of its inventoried property has been poor. All too often the properties are allowed to deteriorate in spite of the fact that they are currently unoccupied.

In this connection, the VA must undertake a more earnest effort to make its property marketable. Keeping these properties attractive has got to be a key to selling more of its property more quickly at prices more closely equivalent to their originally assessed value. Typically these properties are boarded up, allowed to deteriorate and fall into disrepair and subsequent vandalization.

The most obvious way, in our view, for the VA to restore solvency to the LGRF is to require the agency to rebuild its home loan portfolio. To accomplish this, the VA will need to be authorized to make many more direct and vendee loans. To do this might be very expensive in the short term, but in the out years such a change in policy would save taxpayer dollars.

Knowing, in these times of federal fiscal austerity, that passage and enactment of such an expensive proposal would be difficult to accomplish, we offer for the subcommittee's consideration two alternative approaches. The first of these would authorize the VA's loan guaranty program to borrow directly from the U.S. Treasury at the discount rate such sums as are necessary to make direct and vendee loans. Funds borrowed would be deposited in a Direct Loan Revolving Fund. The loans then made by the VA would be at the same maximum interest rate set by the Administrator. The VA could inventory these loans in the redevelopment of its portfolio or it could assume some portion of the loans into pools of mortgage backed securities, depending on which option offers the VA the best financial advantage. These

mortgage backed securities could be offered to investors in the secondary mortgage market or retained in the portfolio.

Another option offering start-up funds without Congressionally approved appropriations would be to utilize some of the unobligated assets in some of the VA's insurance accounts. In the National Service Life Insurance (NSLI) account alone there is over $9.8 billion in unobligated assets that could be drawn upon and repaid once the home loan portfolio begins to generate sufficient income.

Madam Chairwoman, that concludes our statement.

Mortgage Insurance Companies of America

Steven P. Doehler
Executive Vice President

March 16, 1988

The Honorable Marcy Kaptur
1228 Longworth House Office Building
United States House of Representatives
Washington, DC 20515

Dear Chairwoman Kaptur:

Thank you for giving MICA the opportunity to provide comments for the hearing record on the Subcommittee's examination of the VA Home Loan Guaranty Program and the long-range solvency of the Loan Guaranty Revolving Fund. I hope the attached statement is helpful.

We commend the Subcommittee for its announced willingness to seek innovative plans that can translate into action. In doing this it cannot be stressed enough how important it is that the Subcommittee to obtain from the VA a detailed analysis of the business it is doing in terms of veterans served and the nature of program risks and losses. The mortgage lending business has undergone change and when examining future solvency it is essential to evaluate how the insuring entity is making adjustments to new risks.

The private mortgage insurers have recently emerged from a difficult period and are well positioned to continue to meet the present and future needs of housing finance. MICA members serve many veterans who opt for conventional financing instead of using assistance from the government and we recognize the importance of helping these families obtaining financing terms that will avoid foreclosure. Providing unrealistic financing may benefit those parties making profits from the transaction but certainly does not benefit the veteran.

MICA supports the VA program and believes the Subcommittee is correct in pursuing solutions that will help it better serve veteran families. We will be happy to respond to inquiries and operational questions that may arise.

Sincerely,

Steven P. Doehler

SPD/xmb

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Washington, DC 20036
202-785-0767
Facsimile No. 785-1175

Statement of the Mortgage Insurance Companies of America Prepared for the Subcommittee on Housing and Memorial Affairs on Oversight of the Solvency of the VA Home Loan Guaranty Program

Monday, March 14, 1988

Madam Chairwoman and Members of the Subcommittee:

The expertise of the members of the Mortgage Insurance Companies of America (MICA*) is in the area of residential lending risk and the business of helping homebuyers obtain mortgage credit by providing lenders a protection against default risk. The loans we insure typically have high loan to value ratios and are attractive to many homebuyers who find it difficult to come up with a large downpayment in buying a home. In many respects, private mortgage insurance is similar to the assistance made available by the VA Home Loan Guaranty Program to Veterans obtaining guaranteed loan commitments. It is also similar in that fees are charged to cover both administrative costs and reserves against future default losses. Private insurance does not involve any government support and if capital employed in the business does not earn a

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*MICA consists of the thirteen domestic private mortgage insurance companies which represent the active firms that help loan originators and investors make funds available to homebuyers by protecting these institutions from a major portion of the risk of default. The current MICA officers are President William A. Simpson of Republic Mortgage Insurance Company, Winston-Salem, NC; and Vice President, William Lacy of Mortgage Guaranty Insurance Corporation, Milwaukee, WI; Secretary/Treasurer, J. Edward Carlton of Integon Mortgage Guaranty Insurance Co., Winston-Salem, NC. MICA also has member companies in Canada and Australia. At the end of 1986, the industry had over $267 billion of insurance in force.

risk-commensurate rate of return, the insurer will be forced to leave that business. Private industry does not have the ability to accept the performance the VA program's Revolving Fund has had and remain viable.

In offering MICA the opportunity to provide recommendations for improvements and innovations in the VA Home Loan Guaranty Program, the Subcommittee asked that emphasis in our comments be placed upon the need to find a true long term solvency plan for the Loan Guaranty Revolving Fund. This is a complex task and would require answering basic questions about the Home Loan Guaranty Program such as:

- What are the program's goals?
- Have the goals changed in response to the changed needs of veterans or the nature of risk in mortgage finance?
- Within what resource and policy constraints must the program operate?
- How can innovative change to the program be introduced?

This last question seems the most realistic for our comments to address. The dynamic market environment in mortgage finance has forced major change on private insurers and our industry's recent experience may be informative as a model is developed for changing the VA program. Despite the recognition several years ago that the VA Home Loan Guaranty Program was beset by serious problems, the "quick fix" approaches have not worked. Meaningful reform is needed and those that have looked only to the past must now answer for the level of taxpayer funds going to pay the losses of the Revolving Fund and for the hardships suffered by the many Veteran families whose loans have been foreclosed.

Several years ago, private mortgage insurance firms were in a similar situation to that of the VA Home Loan Guaranty Program. This can be confirmed from the private industry's high losses. Although losses are still high from past business, the industry is now again building financial strength with new additions to capital and new entrants. At that time, private insurers began a planning effort to mobilize the changes needed to maintain financial solidity. They had to attempt to understand the nature, causes and possible solution to the foreclosure problem and focus on areas where structural changes to the existing system could be made. There are likely to be relevant parallels from the private industry's experience that would provide some understanding for the Subcommittee's efforts in examining the VA program.

Mortgage insurers saw that changes in the mortgage finance system had occurred which in turn changed the nature of the risk in mortgage lending and the business of mortgage insurance. There were many facts to bear this out: In the last five years, the private insurers have incurred almost $5 billion in direct losses; thrifts and other lenders have increased the level of real estate owned on their book tenfold since 1980; and the Housing market under went dramatic shocks such as property value declines for homes in the energy states of as much as a third off their highs of several years earlier.

The trends beneath the facts tell more of the story. For example, as inflationary forces were increasing in the early 1980's, there were major deviations from traditional underwriting standards. Inflationary expectations placed volume and profit goals

above sound underwriting principles. Dramatic increases in interest rates caused lenders to respond with new financing techniques that would offer homebuyers more liberal terms in qualifying for credit. Many mortgage loans being originated and insured did not have sufficient credit quality to withstand wide economic fluctuations that were to come especially in those areas with volatile economies.

Another trend was the increased mobility of capital available for real estate financing. Areas that demonstrated higher potential profits were able to attract, through the use of secondary market, new funds which encouraged overlending and overbuilding. Experience now shows that overheated markets will lead to significantly greater frequency and severity of loss from mortgage defaults when an economy turns downward.

Probably the most significant trend was the erosion of quality control that resulted in a lower level of borrower equity in many transactions. The primary underwriting of many loans involved poor judgment as to reasonable credit underwriting and the appraisal. Many lenders were not concerned with the long-term viability of their own lending operations and were not underwriting as though the loans were to become a part of their own portfolios in which they would retain an ownership interest. Too many loans lacked an accurate assessment of beginning equity backed by a valid and professional appraisal. Too many loans involved types of fraud and misrepresentations in the primary underwriting and the examples that were documented by private insurers were probably duplicated by the VA's insuring experience; examples include nonexistant downpayments, no intent to occupy, inflated borrower incomes, exclusions of debt

obligations, faulty appraisals, and the use of straw buyers. It became very evident that lenders must join forces with the insurer to protect the interests of all parties in the mortgage.

Mortgage insurers found in the planning process that there were many underlying causes that posed a threat to solvency from high foreclosures. They needed to be identified and measures were developed that would correct the problem.

A first measure taken by the private insurers was to look at risk management techniques for strategies of change that would ensure continued strength and service to the housing industry. This, of course, had to begin with an analysis of the character of the business that had been put on the books. It was essential to identify the most adverse risks. This meant looking at loan types, borrower types and the performance of the insured/lender doing the primary underwriting.

From the analysis done by insurers using their records of results of their underwriting guidelines and detailed analysis of claims, inordinate risks were addressed and new underwriting guides were applied based upon local conditions. It was clear, for example, that a successful mortgage insurer could no longer afford to deal with poorly managed lending operations or with lenders whose programs presented inordinately high risks. The business practices of a few lenders could jeopardize the reserves that all policyholders had contributed to. The many lenders who had operated prudently should not be penalized by the bad performance of a few;

nor should the availability of insurance to the borrower be curtailed.

Moreover, the mortgage insurer had to be sure that he was adequately being paid for the risk assumed. Since an insurer cannot maintain its financial strength over time if it consistently and persistently assumes inordinately high risk for low premiums, changes were in order. The risk assumed by a mortgage insurer is a long term risk, and the premium must reflect not only the present economic conditions of the area and risk characteristics of the borrower but the risk that a future economic catastrophe can occur in that local or regional area. The lender purchasing mortgage insurance is expecting to receive a financial guarantee against some portion of loss and this ultimately depends upon the insurer's continued future financial strength.

In sum, the planning strategies of the insurers had to include alternative ways to select and evaluate its customer base (insured lenders) and the repricing of risk. Importantly, the basic principle of risk sharing or coinsurance had to be reinforced. Lenders who took steps to underwrite for the long term would continue to receive maximum service so they could, in turn, provide the benefit of default insurance to the home borrower. Lenders with poor performance had to be encouraged to improve.

MICA is not aware of the degree of analysis that the VA has made of its foreclosed loans to determine the areas of major risk. Such analysis would be an essential first step in order to review program policy for underwriting criteria and other elements that can affect

losses. Basically the approach to restore the Revolving Fund to self-sufficiency has to include policy for underwriting both the borrower and the lender and appropriately sharing the cost of risk with lenders and borrowers.

Here are several recommendations that the Subcommittee may wish to consider:

1. Since the program is intended only for creditworthy Veterans and the program is ill-served by approving noncreditworthy Veterans for loans, it is essential to examine a detailed analysis of the default experience of program loans to identify which borrowers are unacceptable risks and why. Private insurers have typically viewed the VA approach to underwriting to be very sound so analysis may show a difference between theory and practice. MICA has substantial resources in terms of data analysis methods which we would be willing to make available to assist the VA.

2. The experience of private insurers indicates a varied performance by lenders in terms of claims experience. Economic conditions of a market area do not account for the differences. Private insurers have had to evaluate individual lenders especially to identify those not maintaining quality control in their primary underwriting. There are a number of very clear indicators such as early payment borrower defaults that point to problems. The VA should rate its customers and determine the quality of business each is supplying. A method of financially penalizing lenders for inadequate performance and rewarding those maintaining strong quality control efforts could be effective.

3. Risk sharing or "coinsurance" is a fundamental principle in a sound insurance program. In the case of private insurers, state law requires them to retain the option to either take title or pay the guaranty amount in settling claims. In effect the "no bid" option as termed by the VA program is in effect for every privately insured loan. The insured obviously would prefer not to share any risk but the private industry and state regulators have determined this is not an economically feasible way to run an insurance operation. It would be important for the Subcommittee to know the cost of the claims settlement method used by the VA in comparison to that used by private insurers. Such information may point to new policy prescriptions.

4. Administrative expenses are another major element of costs of an insurance program. The VA may need to compare the overall program operating costs in a manner that would reveal what the expense would be to provide the same benefit to the veteran by contracting with private firms. This could help design program improvements or policy changes.

5. Evidence clearly shows that the nature of default risk has changed and an insurer's underwriting and product pricing practices must change in response. A single price for all coverages for all borrowers may no longer be appropriate in the dynamic mortgage market. The VA may wish to experiment with pricing risk to the market. For example, it may be advantageous to have different premiums based upon the equity that a veteran puts down at the time of purchase. Equity bears such a significant relationship to the probability of default that the VA may wish to charge borrowers who

save and make a downpayment and proportionately lower premium based upon the reduced risk to the revolving fund than the higher ratio borrower. Private insurers cannot insure 100 percent LTV loans but the experience with 95 percent LTV is that they are twice as risky as 90 percent and four times as risky as 85 percent high ratio loans.

6. The VA program also should make an intelligent examination of reinsurance methods and of the pooling concept. It might be practical, for example, that the VA pool each year of business and set premiums on an adjustable basis to keep premiums at the minimum for the veteran but allow increases spread across the pool that would aid the objective of a self-supporting fund. If reinsurance was to be tested it could help the program share losses and would also identify what the insurance market perceives to be program weaknesses.

In providing these comments it should be made clear that MICA supports the desire of those in Congress who want to maintain a homeownership benefit as an entitlement for the eligible Veteran. We must find ways to put government housing support to its optimal use and provide services to the veteran better and cheaper than has been the case. Valid program improvements must be sought. MICA will be happy to respond to any questions that the Subcommittee may find as it develops a plan for reform. We appreciate this invitation to provide comments.

USL
UNITED STATES LEAGUE of SAVINGS INSTITUTIONS WASHINGTON OFFICE
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March 16, 1988

The Honorable Marcy Kaptur
Chairwoman
Subcommittee on Housing and Memorial
Affairs
Committee on Veterans Affairs
335 Cannon House Office Building
Washington, D.C. 20515

Dear Madam Chairwoman:

Last year the U.S. League was pleased to have the opportunity to offer our views to the Subcommittee on Housing and Memorial Affairs of the Committee on Veterans Affairs of the U.S. House of Representatives in your oversight capacity of this program. As we noted at that time:

"A Review of our legislative policy reveals sound support for Title III of the Servicemen's Readjustment Act, Public Law 346, since it was enacted

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*The U.S. League of Savings Institutions serves the more than 3,200 member institutions which make up the $1.4 trillion savings association and savings bank businesses. League membership includes all types of institutions -- federal and state-chartered, stock and mutual. The principal officers include: Theo H. Pitt, Jr., Chairman, Rocky Mount, North Carolina; B.R. (Barney) Beeksma, Vice Chairman, Oak Harbor, Washington; William B. O'Connell, President, Chicago, Illinois; Philip Gasteyer, Executive Vice President and Director of Washington Operations; and Brian Smith, Senior Vice President, Regulatory Operations. League headquarters are at 111 East Wacker Drive, Chicago, Illinois 60601. The Washington Office is located at 1709 New York Avenue, N.W., Washington, D.C. 20006. Telephone: (202) 637-8900.

June 22, 1944. We believe that Veterans, because of their sacrifice for this nation, are a special class of people deserving of the many benefits contained in this legislation. We also believe it is appropriate to periodically review the program's strengths and weaknesses to make it more adaptable to today's conditions. Enlightened policy and effective management can result in improved delivery of services to the veteran in the most cost effective manner for the government. This will insure that the program is accomplishing what it was intended to do originally by the Congress and needed changes are made as appropriate to meet changing economic conditions."

We believe that since it's inception the VA program has operated overall in an admirable fashion considering the no down-payment and high loan-to-value ratio loans that have been guaranteed. We do recognize with the increase in foreclosures there has been increased cost to the government for this entitlement program and to the lender as well. Many new enhancements and innovations have been developed through the years including the "automatic guarantee" program which has speeded up processing of these loans. Allowing the prior approval procedure to be available and also operate allows lenders to select the program best suited for its size and method of operation. However, with any program that delegates more authority to the lender the VA's quality control system must quickly track those few lenders that are not consistently meeting the minimum standards of the program.

We commend the subcommittee for looking at long range solutions rather than "quick fix" answers to making the program as viable as it should be in serving the needs of veterans and at the same time keeping the cost to the taxpayer at a minimum. This process is needed for every program of the Federal Government. The U.S. League has been very vocal about the need to balance the federal budget and reduce the deficit.

Overview of Program

The present problems of the depletion of assets of the Loan Guarantee Revolving Fund must be examined in view of the problems experienced in all sectors of the lending community based on severe depressed economic conditions in many geographical areas of our county. These conditions have impacted all lenders in addition to the VA. However, the fact that this is an entitlement program with no down payments means it can be more severely impacted by a poor economy since many of the veteran borrowers had little equity and personal financial reserves to fall back on in the event of personal financial difficulties. In other words, given the no down payment feature of the program, there is always the possibility that there would be more problems than with programs requiring larger equity in order to qualify for a loan under present and probable future economic conditions.

The Congress has wisely made a number of improvements per the Veterans Benefits Improvement and Health Care Authorization Act of 1986. Since these changes have been in effect a relatively short time there is little operational history. However, the changes in the program should be reviewed to see if they are operating as intended. Will the changes considered here and those made recently by the Veterans Home Loan Program Improvements and Property Rehabilitation Act of 1987 provide adequate program design to prevent future problems of heavy foreclosures and the resulting losses that are largely responsible for the depletion of the reserve fund? Given the present economic environment, does the administrator have the tools he needs to keep the program viable or does the entire concept of the program need review and possible policy changes to make it viable for today's totally different environment that when it was introduced 44 years ago?

Congress needs to address the present concept of the program, improvements in the delivery system of it and the costs to continue to fund it today and in the future.

The original concept was to provide a returning veteran the opportunity to own his own home. Many veterans had served for four or more years at low military pay. The no down payment feature enabled them to buy a house. Amortization of the loan and inflation in subsequent years permitted equity build up. If the program is ever reduced in scope, the availability of additional guarantee authority for subsequent house purchases may not be as essential as acquiring the first home. In addition, some down payment may be needed. The private mortgage insurance companies have had to review and adjust their program for high loan-to-value loans because of increased loss experience. We recognize that elimination of veterans participating in subsequent house purchases could eliminate some of the strongest financial borrowers from the program with reduction in overall portfolio quality. However, other veterans' benefits have not continued without a time limit. For example, the G.I. Bill Educational entitlement had a sunset provision for the veteran to take advantage of this benefit. However, the point is that Congress needs to know what the present entitlement program under its present concept will cost today and have good projections for future years.

Although improvements are constantly being made in the mechanics and administration of the VA Home Loan Guaranty program, the agency should review the progress being made by Freddie Mac and Fannie Mae. These secondary market agencies have improved the technical and mechanical aspects of their programs by giving the lender more authority and having him warrant to the

appropriateness of his actions. The VA automatic guarantee system is a step in this direction. We understand it is being expanded to include more lenders. We anticipate the loan quality experience will be better than with the prior approval procedure.

Another area of concern is appraisals. Cases where there has been a serious reduction in value and consequent loss to both the VA and lender should be carefully analyzed to examine the professional quality of the appraisal at the time the loan was made. With the losses being suffered under the no bid procedure the lender could be better off selecting his own appraiser. The VA should look at the appraisal fee for VA appraisers, which is usually about half for conventional appraisals. Does this fee secure the experienced appraiser who can devote the needed time to the case? With 100% loan-to-value ratio the appraisal must be the best it can be. We recognize that Section 1810(b) and 1831 were amended per the Veterans' Home Loan Program Improvements and Property Rehabilitation Act of 1987 with respect to the establishment of uniform qualifications of appraisers on loans guaranteed, insured or made by the VA (including development of written tests for appraisers), and the authority of certain lenders to (1) make automatically-guaranteed loans, and (2) review appraisals and make determinations of reasonable value of the property. This should help the situation.

Last year, in our prepared statement, we indicated that the regulation, effective April 3, 1987 to initiate a pilot program to offer vendee loans for sale, without recourse should be utilized. We recognized at the time that loans sold without recourse would have to be sold at a lower price. However, it was our suggestion that accurate cost analysis be prepared under both methods so the most cost efficient method could be determined for sale of these "4600" loans. The experience under the pilot program should be reviewed and evaluated, recognizing that parts of the VA portfolio, because of property location and condition, would have low value relating to original loan amounts under either approach.

Amended Sections 1816(c) and (d) improve the "no-bid formula", in that excluded is interest accruing after unreasonable delay in the liquidation sale of the property caused by the VA or by VA-requested forbearance . This makes the program more viable from the lenders viewpoint.

The following comments are offered related to the mobile home program:

1. Any consideration to changing the funding mechanism for VA guaranteed loans must recognize the distinct characteristic difference between mortgage loans and mobile home loans. Those differences must be factored into any study of the alternative and no attempt should be made to develop one insurance funding vehicle that would include both mortgages and mobile homes.

2. Any consideration to an insurance program for mobile homes should not use FHA Title I as a base, since that program is not working.

3. Strong consideration should be given to retaining the present funding fee vehicle, but supplement the program with rules which would reduce the exposures to losses and repossession.

4. Recognition should be made to the fact that a government program must be such that it will not provide everything for everyone -- and that certain veterans should not qualify for certain loans. If loans are to be made available on the best terms in the market to all veterans regardless of their ability to repay those loans, then no funding mechaniem will be able to handle the losses.

Mortgage Insurance Versus 1% Funding Fee

This issue is before us because of the magnitude of foreclosed real estate and the losses that will have to be taken now or in the future. Congress must ask whether the present 1% fee is adequate to carry the inventory until judicious timing suggests sale in present severely depressed markets. It is our feeling that it is not adequate and even the 2-1/2% recommended by the Administration last year may be inadequate. A change to a properly structured mutual mortgage program, similar to the FHA 203 program, would provide needed resources, if we were starting from the inception of the program. This would have provided an actuarially sound fund. The FHA needs over 3% up front to continue a fund that was started years ago, when substantial reserves could be built up before the present severe economic problems. What would the new veteran borrower have to pay for shortage of funds in the present Loans Guarantee Revolving Fund? What appropriations will be required from Congress -- so future users of the program will be paying their share, but not subsidizing the fund for past users of the program. We understand a study is being undertaken by the VA. This should help determine the viability of this approach.

An insurance pool that could be invested is probably a major benefit of this approach in that income could be received on invested assets. This is not possible with the way the present revolving fund is structured.

Maximizing Governments Returns On Its Loan Assets

Section 1816(d) relating to proportions of properties acquired by the VA as a result of defaults on VA-guaranteed loans that can be sold for cash and by "vendee loans," was amended to extend sunset date to 1990 and increase the cash sale percentage to a minimum of 35% and a maximum of 50% from a minimum of 25% and a maximum of 40%. While in theory establishing fixed percentage of properties to be sold for cash may encourage the administrator to sell more for cash and replenish the revolving fund. However, in practice each geographical region will have to be analyzed to determine the best present value for sale of assets in that region and still keep within the overall percentage mandated by this legislation.

The amendments to include amounts for the rehabilitation of the property as part of the vendee loan amount and exercise of discretion as to the 5% downpayment requirement should give the administrator needed flexibility to handle each case in the most appropriate manner.

The problem of depressed economies, particularly in the Southwest, makes the careful analysis of the VA portfolio and its careful disposition extremely important. Because of the poor real estate market and the surplus of properties available from the entire lending community, a fire sale approach could be counter productive. For example, if the VA sells a property at a price way under the original purchase price in the area and provides a vendee loan to the purchaser, what does that do to the other VA borrowers in the

immediate area who are making payments on a house now worth, according to the above subject comparable, much less than the mortgage they owe. Would not they be inclined to walk too?

We recognize the VA is carefully tracking in each market the status of its inventory and the various options for disposition of each property. We would suggest that each loan be carefully examined so that each loan is carried per the most professional estimate of the best time to sell it considering the potential rental income and the costs to carry it. As part of the REO workout, each problem asset must be analyzed to determine what caused the problem and how the problem can be solved. The risks and rewards of various strategies and tactics can be evaluated based on the options for structuring the workout with the objective to sell at market value after an objective appraisal of each approach has been built into a financial model of the various solutions. A marketing plan will need to be developed that will result in maximum investment recovery. Professional property management needs to be utilized either internally or through outside professionals while the property is held in inventory.

We appreciate the opportunity to submit our comments to the Subcommittee. The U.S. League will continue to suggest a viable home loan program for deserving veterans. We will be happy to offer any assistance we can to the efforts of the Subcommittee.

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Office of the
Administrator
of Veterans Affairs

Washington DC 20420

Veterans
Administration

MAY 2 1988

Honorable G. V. (Sonny) Montgomery
Chairman, Committee on Veterans'
Affairs
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed please find the Agency's responses to the questions which you forwarded on behalf of Congresswoman Marcy Kaptur and Congressman Dan Burton for the March 17, 1988, hearing by the Subcommittee on Housing and Memorial Affairs. Thank you for the opportunity to provide this additional information for the record.

Sincerely,

THOMAS K. TURNAGE
Administrator

Enclosure

cc: Congresswoman Marcy Kaptur
Congressman Dan Burton

WRITTEN COMMITTEE QUESTIONS AND THEIR RESPONSE

QUESTIONS OF THE HONORABLE MARCY KAPTUR
TO THE HONORABLE THOMAS K. TURNAGE
VETERANS ADMINISTRATION
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
MARCH 17, 1988

QUESTION 1: It has been brought to my attention that last week five underwriters were selected to handle non-recourse portfolio loan sales for the VA. It is my understanding that some of these firms worked on the sale of Farmers Home loans and that once the commissions were paid, etc., the Federal Government netted approximately 44 cents on the dollar. Do you think that is what we can expect?

RESPONSE: VA's budget projections anticipate a return greater than that received by Farmers Home. We expect proceeds of more than 70 cents on the dollar from the sale of newly originated portfolio loans and a return of 50 cents of the dollar from the sale of older loans, with below-market interest rates, from our portfolio.

QUESTION 2: Could you please provide the terms of agreement with each of the underwriters selected to participate in the sale of portfolio loans?

RESPONSE: At this time, no written contracts have been signed with the underwriters. They have agreed to proceed with all arrangements for the sale with the understanding that they will bear their own costs if the sale does not take place. When the sale arrangements are completed and the securities being collateralized by VA's loans are priced, a sales agreement will be negotiated by all parties.

QUESTION 3: The fiscal year 1989 budget indicates that loan sales during 1989 will be non-recourse. Will the services of financial advisers and underwriters continue to be necessary during 1989?

RESPONSE: Yes, for 1989. We're not certain thereafter.

QUESTION 4: I note on page 12 your support for the Administration's policy of dumping assets. Granted, prudent portfolio management will take a number of years to make the fund solvent, but what are our prospects for ever achieving solvency if you continue to deplete your assets at 50 cents on the dollar?

RESPONSE: The non-recourse sale of loan assets is intended to reveal the market value of these assets and expose any inherent subsidy resulting from Government involvement in the loans. In addition, the sale process will reveal any deficiencies in VA's credit management processes. Identification and correction of such deficiencies will enable VA to strengthen the quality of its loan portfolio and increase the value of portfolio loans for purposes of future sales.

QUESTION 5: The General Accounting Office has historically testified that loan sales should either be made with recourse or even that they shouldn't be sold at all so that the Federal Government could increase its proceeds. If you held onto your loan portfolio, at what point in time would you end up making more money than by selling them in the beginning?

RESPONSE: It is very difficult to project with any degree of precision how long it would take to accumulate a portfolio with sufficient cash flows to offset the deficiency in the revolving fund. There are many variables that impact on such an estimate, e.g., the number of vendee loans established is a function of property acquisitions and sales which inturn reflects economic conditions.

However, under existing law it would most likely take 7-10 years or more of holding vendee loans to eventually reach a point where the portfolio income fully supported the program.

We do not advocate such a course of action. The VA fully supports the Administration's credit reform policies which include timely disposition of loan assets on a non-recourse basis.

QUESTION 6: GAO testified last year that increased servicing would lead to fewer foreclosures and ultimately save money. My bill required increased servicing and, in addition, the appropriations committee allocated $1 million specifically for that purpose. However, it is my understanding that you are now planning a pilot test on the impact of increased levels of servicing on loan foreclosure rates in only one regional office. Isn't this pilot test a disregard of Congressional intent?

RESPONSE: We are making a concerted effort to increase servicing at all VA offices. Since Houston has been a depressed area, and has the greatest foreclosure activity for any one office, we feel that a specific program to increase cure ratios would be most appropriate at that office. For that reason, we are concentrating additional servicing staff in that office.

QUESTION 7: In your written testimony when you discuss rentals, you suddenly switch from local to nationwide considerations. Suppose we go back to talking about Houston. What is contra indicated about renting there?

RESPONSE: With nearly one-quarter of VA's nationwide property inventory being situated in the Houston region, our reservations about a significant rental program for VA are applicable to the Houston region. Substantial cash flow infusions to the Loan Guaranty Revolving Fund, in order to limit the need for Congressional appropriations, can only come through sales - not through rentals. Since the Houston region has more properties than any other region, those properties must be sold to provide the needed cash flow to the Revolving Fund.

QUESTION 8: Fiscal Year 1987 was a record year in property sales with over 34,000 sold. According to our estimates, your auctions in Houston have been netting you approximately 40 cents on the dollar. It is my understanding that you envision selling 45,000 properties in Fiscal Year 1988 and that the only way you can do this is by having an auction a week as well as to use liquidation sales. Do you believe an auction a week can really be accomplished?

RESPONSE: We believe that it is practicable to conduct an auction a week.

QUESTION 9: Recognizing the problems in Houston, Muskogee, and Denver, aren't the remedies you have adopted calculated to increase rather than minimize your losses? (Higher commissions, lower prices, auctions, etc.) If you continue this practice, will not the decrease in inventory also generate greater future deficits in the Loan Guaranty Revolving Fund?

RESPONSE: The sales techniques that we are using in Houston, Muskogee, Denver and other locations are not intended to increase our losses. In pricing, for example, our field stations are told to price the properties for sale in today's market. In markets that are flat or declining, this practice might be seen as reducing the losses that might otherwise be realized if the properties remained unsold in such markets. Similarly, with sales commissions and bonuses increased to be competitive in the marketplace, brokers may work harder to sell VA properties faster. As a result of broker competition, prices for properties could be higher, and VA would avoid certain holding costs and market value declines.

The strategy for marketing real estate reflects a balance between the often competing interests: best price and fastest disposition. Since the overriding need at present is to minimize appropriations to operate the Loan Guaranty program in the near term, we have shifted our emphasis more in the direction of speed of disposition.

QUESTION 10: What percent of properties in inventory are currently rented? Could you please provide a geographical breakdown?

RESPONSE: Approximately .28% of our nationwide inventory (70 properties) is rented. The number of properties rented by each of our regional offices is as follows:

Indianapolis	IN	42
New Orleans	LA	7
St. Paul	MN	5
St. Petersburg,	FL	4
Chicago	IL	3
Denver	CO	2
Togus	ME	1
Buffalo	NY	1
Manchester	NH	1
Detroit	MI	1
Houston	TX	1
Los Angeles	CA	1
Salt Lake City	UT	1

QUESTION 11: You stated in response to a followup question from the March 2, 1988 hearing, that the nationwide ratio of properties in custody to employees is 95:1, and specifically, in Houston this ratio is 190:1 and in Denver, it is 278:1. What level of employment would be needed in Houston to bring this ratio in line with the national average? What about for the Denver area?

RESPONSE: Employment in the property management activity at Houston RO would need to be doubled (an increase of 41 FTEE). At Denver, employment in property management would need to be tripled (an increase of 28 FTEE).

QUESTION 12: Do you think that many of the VA's policy decisions would be different if the program wasn't nearly broke?

RESPONSE: We do not believe the program's funding problems have improperly influenced our policy decisions. The Loan Guaranty Revolving Fund has been experiencing severe financial difficulties since FY 1984 when appropriations were first required to offset rising program costs. During this period we have always tried to operate the program in a manner that effectively provides the benefits and services veterans are entitled to under the law. In addition, we have not lost sight of our responsibility to operate this program in the most cost effective means possible.

QUESTION 13: Will your 1989 budget request permit you to adequately implement Public Law 100-198?

RESPONSE: We believe that all the provisions of Public Law 100-198 can be implemented with the resources requested in the FY 1989 budget submission. This Law made numerous changes to the program, e.g., extension of the funding fee, two-tiered guaranty percentage, five-percent downpayment on manufactured homes, etc. Many of these changes do not require additional employment to implement. Policy and procedural directives, regulation changes, and revisions to computer systems are being accomplished by Central Office staff.

QUESTION 14: On page 12 of your testimony, you refer to the use of an outside contractor to make a more detailed analysis of the feasibility of utilizing mortgage insurance. Could you please provide us with a more detailed explanation of precisely what is expected from the contractor and the time frame for completion?

RESPONSE: The contractor is to conduct a feasibility study of various mortgage insurance options as a cost-effective veterans housing benefit. Topics which must be explored include the design of a viable insurance program which maintains its status as a veterans benefit, the premiums which would have to be charged, who would pay them, the size of a reserve which would be necessary, the total costs of the program, etc.

This will involve development first in broad outline of at least three different approaches to a mortgage insurance program for veterans, with roughly estimated costs and reserve requirements.

Upon approval by VA, the contractor shall develop in detail the option chosen by VA, including actuarial analyses, an estimate of premiums which would have to be charged, who would pay them, the size of a reserve which would be necessary, the total costs of the program, the effect implementation of such a program would have on the existing obligations of the Revolving Fund, etc. Consideration must be given to the fact that any such program should maintain the characteristics of the GI home loan benefit program.

It is anticipated that work will be completed 126 workdays after award of the contact. We expect that the contract will be awarded in the next few weeks.

QUESTION 15: GAO states in their testimony that "although VA maintains that its offices consider foreclosure alternatives in handling each default, VA has not developed and documented a least cost analysis that compares the cost of the various alternatives." Is this a true statement? If so, could you please provide an explanation as to why this is not common practice?

RESPONSE: VA considers the circumstances in every case and determines which method of termination is most appropriate for the veteran and for the Government. We have not devised a specific form for action at each particular step in the default and foreclosure of a GI loan. These procedures are clearly delineated in our manuals and circulars issued to each office. We have discussed GAO's ideas in this matter and have invited them to show us a logically structured example of what they are proposing.

QUESTION 16:. The NCOA in their testimony asks congress to repeal the "Net Value" provision of Public Law 98-369, as it relates to the establishment of debt assessed against a veteran. If the veteran were given credit for the full market value of the property at foreclosure, rather than the net value of the property to the government, the amount of eventual liability could be reduced or eliminated. Could you please provide comments on the above concept.

RESPONSE: When VA is required to pay a claim as a result of a GI loan default, a liability account for an indebtedness corresponding to the amount of claim paid is established against the veteran-borrower pursuant to 38 CFR 36.4323(e). This regulation is consistent with the law governing the GI loan program and has been reviewed by the Congress. While it is true that veterans' debts could be reduced or eliminated if full market value was credited against the indebtedness, such action would require legislation.

QUESTION 17: The National Manufactured Housing Finance Association states that "One of the most common complaints voiced by lenders is the inconsistency of guidance and interpretation of VA Regulation and policy provided by field offices, which routinely vary from one another and from VA Central." In a letter to the subcommittee, the Association cited this as one of the most exasperating problems experienced by the lender community. VA responded to the subcommittee's inquiry in January 1988 that it was currently reviewing a draft manufactured home loan manual. What is the status of this manual? When can we expect the final version will reach field stations?

RESPONSE: The manual is still in the drafting process. Within three months it should be ready for review and editing. Following that it will be cleared for printing. We hope to have it published and distributed by January 1989.

QUESTION 18: GAO states in their testimony that a two percent increase in the cure ratio would reduce losses by about $55 million. When asked the question of what level of employment would be needed to produce this result, you stated that you had provided GAO with these statistics. Could you please provide a copy of your analysis which produced these statistics.

RESPONSE: In our discussions with GAO it was pointed out that more cures of GI loan defaults would produce substantial savings to the Loan Guaranty Revolving Fund. It was explained that a two percent improvement in the ratio of cures to total defaults processed would result in a savings to the revolving fund of approximately $48 million.

This was calculated as follows:

1) 170,000 defaults in a fiscal year

2) The cure ratio improves by 2% (71% to 73%)

3) Average claim in FY 1988 is estimated to be $14,100

.02 X 170,000 X $14,100 = $47,940,000

However, we did not provide GAO with a figure of additional FTE necessary to improve the cure ratio by two percent. We are soon going to conduct a pilot test of the impact of increased levels of servicing and housing counseling assistance of loan delinquency and foreclosure rates. Ten additional loan servicing technicians will be hired in the Houston Regional Office to determine the cost-effectiveness of an additional level and reduced foreclosures. Analysis of the pilot test data should enable the Department to more efficiently allocate resources in the loan servicing function.

QUESTIONS OF THE HONORABLE DAN BURTON
FOR THE RECORD OF MARCH 17, 1988
OVERSIGHT HEARING ON THE SOLVENCY OF THE
VETERANS ADMINISTRATION HOME LOAN GUARANTY PROGRAM

QUESTION 1: What is the default rate on vendee accounts. Do you have different credit standards for these houses as compared to GI loans?

RESPONSE: As of December 31, 1987, 27.7 percent of all VA portfolio loans were in default. However, this figure is somewhat misleading in that VA has been continuously selling the current vendee loans to meet expenses of the Loan Guaranty Revolving Fund. What is left is a residual of loans in default as well as older, low interest rate accounts.

The credit standards for establishing vendee accounts are the same as that for guaranteed loans.

QUESTION 2: Please explain how you operate in the energy belt as compared to other government agencies.

RESPONSE: VA operations in energy belt States are substantially the same as operations of other government agencies.

QUESTION 3: Why has the VA not accepted more deeds in lieu of foreclosure? What is the cost factor involved?

RESPONSE: VA considers acceptance of a deed-in-lieu of foreclosure whenever one is offered, and approves acceptance of such an offer when it is in the best interest of the veteran and the Government. There are many situations in which it is not possible to obtain a deed. Often, the homeowners prefer to remain in the property without making payments as long as possible. Sometimes it is not possible to locate all obligors, or one borrower agrees to tender a deed but a co-borrower refuses. Even when a deed is tendered by all obligors, secondary liens may prevent VA from accepting it. Cost factors involved in accepting more deeds include conveyance of more properties to VA and surrender of VA's right, in whole or in part, to pursue collection of debts from borrowers who default. These are partially offset by savings due to a reduction in accrued interest, foreclosure costs and advances for taxes and insurance. We are, however, unable to quantify the relative affects of these factors.

QUESTION 4: How many more people would VA need to effectively service defaults?

RESPONSE: We believe that effective servicing of GI and portfolio loans can be accomplished with the resources requested in the FY 1989 budget submission.

The Loan Guaranty Program has its roots in the original GI bill and has always been administered within the VA's benefits delivery organization. From 1944 to 1961 the program was funded by the Readjustment Benefits Appropriation Account. All program costs due to foreclosures of GI loans were paid from this account, which received annual appropriations. Collections generated from the sale of acquired properties were returned to the U.S. Treasury. There was no attempt that we can identify now to make the program self sustaining. It was understood that expenses would exceed collections and that appropriations would be necessary to support the program. In fact every fiscal year between 1947 to 1961, appropriations were made to the Readjustment Benefits Account to fund program expenses.

In 1961 (FY 1962) the Loan Guaranty Revolving Fund was established. The purpose of the revolving fund was to put the program financing on a more business like basis. Operationally, the program would be no different. However, receipts from program operations would be deposited into the fund and be available immediately for ongoing expenditures. The revolving fund would allow for improved budgetary and accounting control as well. In establishing the Loan Guaranty Revolving Fund, Congress authorized transfers from the Direct Loan Revolving Fund as may be necessary to offset shortfalls previously funded by appropriations. The Direct Loan Revolving Fund had been established in 1950 to make direct loans to veterans living in rural areas who could not obtain guaranteed loan financing. Principal and interest collections on direct loans far exceeded new lending requirements which provided a source of funds for the guaranteed loan program in lieu of direct appropriations. The concept was that one veterans housing program (direct loans) could support the other (guaranteed loans) without appropriations from Congress.

During the first six fiscal years of the revolving fund's existence (1962-67) $633.9 million was transferred to the fund. At this point the program had been operating 23 fiscal years (1945-1967) and in 21 of those 23 years appropriations or transfers had been necessary to offset program expenses. Clearly the Loan Guaranty Program was not self sustaining up to this point.

However, for the next 10 fiscal years (FY 1968 - FY 1977) the revolving fund operated without transfers from the Direct Loan Revolving Fund or appropriations. During this period there were 4 fiscal years and the transition quarter in which collections to the fund exceeded expenditures. This change in the historical pattern of costs and collections gave the impression to many observers that the Loan Guaranty Revolving

Fund was self sustaining. In fact, the revolving fund performance reflected overall economic conditions. The economy was relatively stable; the GI mortgage interest rate maximum was in the 7-9 percent range; foreclosure rates and unemployment were low; and real estate values were appreciating sharply. Many veterans who did face financial difficulty during this period were able to dispose of their properties and satisfy their indebtedness without losses being incurred by VA. In fact, during the 1970's home price appreciation averaged 10.9 percent which allowed thousands to escape foreclosures that would undoubtedly occur in many regional markets today.

It should be noted that VA's experience with low foreclosures was not unique. The FHA (203B) program had a very similar foreclosure trend as did conventional mortgage loans.

The financial condition of the revolving fund began to change in the late 1970's. In FY 1978 $100 million was transferred from the Direct Loan Guaranty Revolving Fund as expenditures exceeded receipts by $80 million. Mortgage interest rates moved up sharply in 1980 in response to changes in Federal Reserve policy. In 1980 the average GI loan interest rate was almost 12 percent. Of all loans guaranteed that year 11.6 percent have gone to foreclosure compared with 3.5 percent of the loans made in 1977. The country suffered severe recession in the 1980-82 period characterized by high unemployment, factory closings and bankruptcies. Particularly hard hit was the industrialized great lakes region and the upper midwest. A decline in automobile production brought on by recession, high interest rates and growing foreign competition severely impacted on the steel, rubber and glass industries.

The agriculture industries of the farming states also were hit hard by this recession. The severity of the economic change can be seen in the increase of VA's property inventory. By the end of FY 1980 VA's inventory of foreclosed properties was 9,023. Just two years later the inventory had almost doubled to 17,269.

As the midwestern part of the country coped with the recession, the southwestern United States began to experience a boom in response to rising oil prices. The price of domestic oil at the well head rose from $9.00 a barrel in 1978 to $31.77 in 1981. During this period there was substantial speculation by investors that oil prices would go higher. The unemployment rates in Texas, Oklahoma and Colorado were well below the national average. The price of oil did not rise further but did remain strong ($24-28 per barrel) between 1982-1985.

However, the price of domestic oil decreased to an average of $12.51 in 1986. The result has been a severe recession in the energy industry which has caused rising unemployment, property depreciation and extremely heavy foreclosures of GI loans. In Texas alone business and personal bankruptcies totaled 37,170 for the twelve month period ending June 30, 1987 compared with 9,589 in June 1981. Since the end of FY 1983 almost $1.7 billion in external financing (transfers and appropriations) have been necessary to support the Loan Guaranty Revolving Fund. The Direct Loan Program (except for Specially Adapted Housing cases) was suspended in 1981. The Direct Loan Revolving Fund has been depleted and no longer can provide the necessary support to the Loan Guaranty Program.

Attached is a chart (Attachment A) which describes the change in property inventory in Cleveland, Ohio and Houston, Texas from FY 1980 to March 1988. This chart clearly shows how changing economic conditions have influenced property acquisitions (costs to the revolving fund) in these two areas. Attachment B describes the concentration of property inventory at the end of fiscal years 1965, 1970, 1975, 1980, 1982, 1985 and February, 1988. These charts illustrate how foreclosures in regional areas have changed through the years.

The subcommittee also requested that VA explain how VA's loan asset sales policies may have contributed to the current program financing problems. VA has sold vendee loans on a regular basis for over 25 years. These sales have generated over $7.3 billion dollars to the revolving fund. The policy has been to substitute private capital for public credit and in doing so to convert loan assets, to cash to fund ongoing program costs. Beginning in FY 1988 these loan assets will be sold without recourse (repurchase agreement) which will still provide vital financial support to the revolving fund without liability to the government in the event of default. The selling of loan assets has had a positive impact on program financing and has not aggravated the revolving fund's current difficulties.

ATTACHMENT A

PROPERTY INVENTORY - END OF YEAR

FISCAL YEAR	U.S. TOTAL	CLEVELAND	% OF U.S. TOTAL	HOUSTON	% OF U.S. TOTAL
1980	9,023	915	10.14	227	2.52
1981	11,515	1,491	12.95	392	3.40
1982	17,269	2,463	14.26	521	3.02
1983	19,962	2,832	14.19	957	4.79
1984	21,895	1,632	7.45	1,685	7.70
1985	18,692	1,479	7.91	1,793	9.59
1986	20,567	1,226	5.96	4,572	22.23
1987	22,633	959	4.24	5,449	24.08
3/31/88	25,172	985	3.91	6,050	24.03

ATTACHMENT B

PROPERTIES ON HAND

JUNE 30, 1965

STATION	TOTAL	% OF U.S. TOTAL	CUMULATIVE TOTAL
DETROIT	2512	14.39	14.39
CHICAGO	1850	10.60	24.98
LUBBOCK	1551	8.88	33.87
ST. PETERSBURG	1281	7.34	41.20
WICHITA	1208	6.92	48.12
NEW ORLEANS	763	4.37	52.49
LOS ANGELES	715	4.10	56.59
SEATTLE	527	3.02	59.60
MONTGOMERY	506	2.90	62.50
HOUSTON	506	2.90	65.40
SUBTOTAL	11419	65.40	
U.S. TOTAL	17460	100.00	

JUNE 30, 1970

STATION	TOTAL	% OF U.S. TOTAL	CUMULATIVE TOTAL
LOS ANGELES	1238	11.88	11.88
ALBUQUERQUE	975	9.36	21.24
WACO	962	9.23	30.47
CHICAGO	809	7.76	38.24
CLEVELAND	635	6.09	44.33
ST. PETERSBURG	565	5.42	49.76
DETROIT	477	4.58	54.33
ST. LOUIS	422	4.05	58.38
NEWARK	401	3.85	62.23
WICHITA	354	3.40	65.63
SUBTOTAL	6838	65.63	
U.S. TOTAL	10419	100.00	

JUNE 30, 1975

STATION	TOTAL	% OF U.S. TOTAL	CUMULATIVE TOTAL
LOS ANGELES	1705	15.73	15.73
HOUSTON	1147	10.59	26.32
DETROIT	942	8.69	35.01
CLEVELAND	839	7.74	42.76
ATLANTA	768	7.09	49.84
NEWARK	431	3.98	53.82
WACO	396	3.65	57.48
CHICAGO	388	3.58	61.06
JACKSON	349	3.22	64.28
NEW YORK	326	3.01	67.28
SUBTOTAL	7291	67.28	
U.S. TOTAL	10836	100.00	

ATTACHMENT B

PROPERTIES ON HAND

SEPTEMBER 30, 1980

STATION	TOTAL	% OF U.S. TOTAL	CUMULATIVE TOTAL
NEW YORK	969	10.74	10.74
CLEVELAND	915	10.14	20.88
NEWARK	731	8.10	28.98
ST. PETERSBURG	660	7.31	36.30
CHICAGO	613	6.79	43.09
SAN JUAN	525	5.82	48.91
PHILADELPHIA	481	5.33	54.24
ATLANTA	426	4.72	58.96
DETROIT	406	4.50	63.46
INDIANAPOLIS	263	2.91	66.37
SUBTOTAL	5989	66.37	
U.S. TOTAL	9023	100.00	

SEPTEMBER 30, 1982

STATION	TOTAL	% OF U.S. TOTAL	CUMULATIVE TOTAL
CLEVELAND	2463	14.26	14.26
CHICAGO	1412	8.18	22.44
DETROIT	1401	8.11	30.55
LOS ANGELES	820	4.75	35.30
INDIANAPOLIS	786	4.55	39.85
DENVER	615	3.56	43.41
NEW YORK	571	3.31	46.72
ATLANTA	523	3.03	49.75
HOUSTON	521	3.02	52.77
SEATTLE	518	3.00	55.76
SUBTOTAL	9630	55.76	
U.S. TOTAL	17269	100.00	

SEPTEMBER 30, 1985

STATION	TOTAL	% OF U.S. TOTAL	CUMULATIVE TOTAL
LOS ANGELES	2229	11.92	11.92
HOUSTON	1793	9.59	21.52
CHICAGO	1569	8.39	29.91
CLEVELAND	1479	7.91	37.82
DETROIT	1012	5.41	43.24
INDIANAPOLIS	960	5.14	48.37
WACO	789	4.22	52.59
DENVER	660	3.53	56.13
DES MOINES	658	3.52	59.65
ST. PETERSBURG	508	2.72	62.36
SUBTOTAL	11657	62.36	
U.S. TOTAL	18692	100.00	

ATTACHMENT B

PROPERTIES ON HAND

FEBRUARY 29, 1988

STATION	TOTAL	% OF U.S. TOTAL	CUMULATIVE TOTAL
HOUSTON	5912	24.00	24.00
DENVER	1906	7.74	31.73
LOS ANGELES	1675	6.80	38.53
CHICAGO	1587	6.44	44.97
WACO	1552	6.30	51.27
DETROIT	1104	4.48	55.76
CLEVELAND	975	3.96	59.71
SEATTLE	830	3.37	63.08
PHOENIX	697	2.83	65.91
INDIANAPOLIS	678	2.75	68.66
SUBTOTAL	16916	68.66	
U.S. TOTAL	24636	100.00	

The Honorable Marcy Kaptur, Chairwoman
Subcommittee on Housing and Memorial
Affairs
Committee on Veterans' Affairs
House of Representatives

MAY 12 1988

Dear Madam Chairwoman:

This letter is in response to your March 23, 1988, request for additional information related to our March 17, 1988, testimony on the Veterans Administration's (VA) Home Loan Guaranty Program. Enclosure I provides our answers to each of the five questions you raised.

I hope that the enclosed information will be useful to the Subcommittee in developing legislation affecting VA's Home Loan Guaranty Program. Please let me know if we can be of further assistance.

Sincerely yours,

John H. Luke

John H. Luke
Associate Director

Enclosure

ENCLOSURE I ENCLOSURE I

QUESTIONS FROM THE HONORABLE MARCY KAPTUR, CHAIRWOMAN
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
COMMITTEE ON VETERANS' AFFAIRS

Question 1: What would be the impact of VA renting properties rather than selling them in areas like Houston until such time as the market improves?

GAO Response

Houston, Texas, economically dependent on the oil industry, is in the process of recovering from an economic depression caused by a drastic reduction in oil prices. As a result of this depression, unemployment and property foreclosures in the area have increased while property values have decreased. This condition has contributed to VA incurring substantial losses on the sale of its foreclosed properties in this area. For example, in fiscal year 1987, VA lost about $88 million on the sale of its foreclosed properties in Houston, or about 25 percent of the total loss VA incurred that year throughout the country.

Renting VA foreclosed properties as opposed to selling them in economically depressed areas would directly affect VA's Loan Guaranty Revolving Fund (LGRF). The primary source of revenues to replenish the LGRF is the sale of VA's foreclosed properties. Therefore, renting a foreclosed property delays its sale and thus revenues for the replenishment of the LGRF. Consequently, in the short term, delaying LGRF revenues might require congressional appropriations to supplement the fund until the properties are sold. However, in the long term, renting may reduce VA's losses if the properties are eventually sold in a healthier housing market.

To determine the costs and benefits of renting versus selling foreclosed properties in depressed areas like Houston, a number of factors should be considered. These include (1) the costs to rent[1] versus the revenues that can be generated from renting these properties, (2) the government's interest cost,[2] and (3) the relationship between the inflation rate and the estimated increase in value of the property during the rental period.

VA regional offices have the authority to rent foreclosed properties if renting is in VA's best interest to do so. According to VA, renting may be in VA's best interest if there is little likelihood of an early sale or if vacant properties are subject to damage by vandals. Many of the VA foreclosed properties in Houston are subject to vandalism and remain vacant for long periods of time while VA is trying to sell them. Nonetheless, because renting delays foreclosed property sales and thus revenues for the replenishment of the LGRF, VA has not rented its foreclosed properties in the Houston area.

The Mortgage Bankers Association and the National Association of Home Builders believe that VA should rent its foreclosed properties in economically depressed areas like Houston because

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[1]The cost to rent includes taxes, insurance, maintenance and repair expenses, and administrative costs to manage the properties.

[2]The government's interest cost is the cost associated with making funds available to acquire foreclosed properties and holding them in the VA inventory for the duration of the rental period.

there is little or no buying market for the over abundance of foreclosed properties in these areas. These organizations believe that when VA sells its foreclosed properties at reduced prices in order to compete with other sellers, it further contributes to this severe supply and demand imbalance which drives property values down. According to these organizations, renting could (1) reduce the adverse effect of selling a large number of properties in a depressed housing market and (2) allow VA to sell properties over time as property values improve.

Question 2: How effective has the VA been in curing delinquencies?

GAO Response

In the early 1980's, VA had a cure rate of about 90 percent. In fiscal year 1987, VA reported a cure rate of 77 percent, the lowest in the 38 years VA has been tracking the cure rate and about 3.5 percent lower than the previous year. If VA had the same cure rate in fiscal year 1987 that it did in fiscal year 1986, VA's losses would have been reduced by about $100 million. VA has not determined the extent to which the cure rate is influenced by its loan servicing activities, but during fiscal year 1988 VA began to obtain data to enable it to make this determination.

VA officials told us that VA's high cure rate in the early 1980's was largely due to homeowners taking action to avoid foreclosure by selling their houses or obtaining a loan to cure their delinquencies. In today's depressed housing markets, like Houston and Denver, these options may not be available to homeowners in view of the sagging economy. This is one reason why VA's programs for compromise sales and refunding, which make funds available to enable the veteran to sell the property or cure the delinquency, are particularly needed by veterans living in depressed housing markets.

Question 3: What is the status of the Committee Chairman's request that GAO review the characteristics of loans in the VA's portfolio?

GAO Response

Our work has shown that VA's loan portfolio, as of March 31, 1988, consisted of approximately 34,000 outstanding vendee loans valued at about $1 billion. Vendee loans are those loans that VA makes directly to individuals purchasing VA foreclosed properties. VA classified about one-half of these loans as loans in default--meaning that the borrowers were one or more months behind in their monthly mortgage payments. The interest rates for all vendee loans range from 3 to 16.5 percent and they have a composite interest rate of 10.6 percent.

VA plans to sell it's vendee loans over the next 3 years, with the first sale scheduled for June 1988. At that time, VA plans to sell about $300 million of these loans for about $176 million, or about 59 cents on a dollar. Overall, VA plans to sell the entire portfolio for about 50 cents on a dollar. One reason for this low rate of return is that VA plans to sell the portfolio without recourse, which means that the government will not stand behind the loans in the event of default. Historically, VA has sold its vendee loans with recourse for about 95 cents on a dollar.

GAO testified in November 1987 before the President's Commission on Privatization and discussed GAO's views on the federal government's efforts to transfer to the private sector its credit activities through the sale of loan assets. We stated that the sale of loan assets would not reduce the structural budget deficit because loan sales simply shift revenues from future years to the year of the sale. We also stated that agencies selling loans should be allowed to structure their sales to achieve the greatest possible net return to the federal government. We reiterated this position in our February 19, 1988, report entitled "Loan Asset Sales--An Assessment of Selected Sales", (GAO/AFMD-88-24).

Question 4: How much money did the VA collect last year from veterans who defaulted on their loans?

GAO Response

The amount that VA annually collects is only a small percentage of the loan guaranty debt owed. The amount collected in fiscal year 1987 was about 2 percent of the total outstanding debt and 6.8 percent of the new debt established that year. Specifically, in fiscal year 1987, VA collected about $30.3 million in loan guaranty debt out of the $1.5 billion that was outstanding during that fiscal year. Of this amount, $6.03 million was collected by offsetting debt against IRS tax refunds; $7.96 million was received by VA from payments made by veterans; and the remaining $16.38 million was collected by offsetting debt against current VA administered benefits (e.g., pensions, compensation and educational payments) to veterans.

In the first quarter of fiscal year 1988, $9.2 million had been collected, which consisted of $2.6 million in payments received from veterans and about $6.6 million in offsets against other VA benefits. Offsets against IRS refunds were not significant since few tax returns were submitted in that quarter.

Question 5: What considerations would have to be made if we wanted to convert to a mortgage insurance program?

GAO Response

Currently, VA has a 1-percent funding fee, which is a one-time payment on a new VA loan. Given that the average new VA loan is about $70,000, each new VA loan contributes about $700 to VA's loan guaranty revolving fund. In fiscal year 1987, VA collected about $311 million from the 1-percent funding fee. One major consideration in establishing a mortgage insurance program is to determine the amount of the contribution that the veteran would make to the insurance fund. In making this determination, the Congress must decide if it wants the program to be self-sustaining.

In an August 1987 report by the Congressional Research Service, it was reported that an actuarially sound VA program would charge a funding fee of about 1.3 to about 1.9 percent of the loan amount. This estimate was based on a loss ratio of between 20 to 30 percent and assumed that VA would not refund the funding fee to veterans whose loans did not end in foreclosure. If VA would refund the funding fee, the estimated funding fee would range from 1.6 to 2.2 percent, according to the report. Therefore, another consideration is whether the new insurance premium would be refundable.

REALTOR®

NATIONAL ASSOCIATION OF REALTORS®

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April 27, 1988

The Honorable Marcy Kaptur
Chairwoman
Subcommittee on Housing and Memorial Affairs
Committee on Veterans' Affairs
U.S. House of Representatives
335 Cannon House Office Building
Washington, D.C. 20515

Dear Madam Chairwoman:

Thank you very much for your letter of March 23, 1988, requesting additional information on the NATIONAL ASSOCIATION OF REALTORS®' testimony of March 17, 1988 by Mr. Bob Muffley. Your letter poses three questions, which we respond to as follows:

Question: You state that for the last 3 years, you have been working with VA to develop a cooperative effort through which REALTORS® can assist in disposing of VA acquired properties. Have you been working with Ohio REALTORS®?

The NATIONAL ASSOCIATION OF REALTORS®' property disposition program has involved and drawn upon the expertise of REALTORS® from around the country, including Ohio. However, we have not yet initiated a property disposition program within Ohio.

Question: On page 3 of your testimony, you state you would find it useful if property descriptions were made available. Could you please explain to me what you mean?

The common practice for the listing and advertising of private homes for sale involves the detailing of useful information about the property upon a local multiple listing service (MLS). For example, such a property listing would likely include the number of bedrooms and bathrooms in the house, whether there is a dishwasher, a washer and dryer, a swimming pool, wall-to-wall carpeting, and information about other amenities. The home's school district and proximity to the nearest public transportation might also be provided. In some cases, a photograph of the property is also available as part of the property listing.

EQUAL HOUSING OPPORTUNITY

REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

Through VA's traditional property disposition program, all the property information that has been available from the Veterans Administration is a property address. This means that a REALTOR® who is interested in identifying a VA property for a potential homebuyer must personally visit and inspect each potential VA property to acquire any specific information. We hope that the VA will assist our joint property disposition program by providing useful multiple listing service information about its properties. We believe that this will significantly improve access of REALTORS® to VA inventoried properties, and thus improve their sales value.

Question: You object to renting VA properties and state, "if the VA rents the property, it will take years to compensate the fund for the cash disbursement. If the VA sells the property, however, the loan guaranty revolving fund is replenished immediately." Could you please explain to me what can happen when a property stays vacant? Isn't some return on our outlay for the acquisition of the property better than no return at all for a period of time? What do you think about the concept of renting with option to buy?

As stated in our written testimony, the NATIONAL ASSOCIATION OF REALTORS® believes that the most cost effective approach for handling foreclosed properties in economically distressed areas is aggressive, orderly and carefully planned disposition programs. To date, the VA has neither adequately managed nor disposed of its acquired properties, but has allowed its acquired properties to go to waste as the inventory accumulates to unacceptable levels.

The VA needs a comprehensive, and effective property disposition program. The fundamental principle of that program should be the sale of property. Once that goal is achieved, we would welcome the Subcommittee's evaluation of other uses for difficult to sell VA properties, including a rental program, or a rental/purchase program. However, at this time such a proposal does not assist the primary goal of selling properties, at a fair price, from the growing inventory of VA properties.

Thank you again for the opportunity to provide additional information concerning the REALTOR® perspective to the VA home loan guaranty program. As always, we are pleased to provide any further information that you may require.

Sincerely,

Stephen D. Driesler
Senior Vice President

1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Mortgage Bankers Association of America

Robert M. O'Toole
Staff Vice President
Residential Finance/
Government Agency Relations
(202) 861-6534

May 11, 1988

Marcy Kaptur
Chairwoman
Subcommittee on Housing and
Memorial Affairs
U. S. House of Representatives
335 Cannon House Office Building
Washington, D.C. 20515

Dear Madam Chairwoman:

Thank you very much for the opportunity to testify before your subcommittee on the VA Home Loan Program.

Attached are my responses to the questions you asked as a follow-up to the hearing. If you need additional information or clarification, I will be happy to provide that for you and your staff.

The VA Home Loan Program is important to the country in many ways. Its primary purpose, of course, is to provide credit assistance to veterans who are purchasing a home. The program is also important to lenders, builders, real estate brokers and the economy in general. The program's continued viability is crucial. Many of us in the housing industry are confident that with you chairing this subcommittee oversight of this program is in good hands.

Thank you again for the opportunity to be part of your oversight process.

Sincerely,

Robert M. O'Toole

1. Question: If the quota for selling a certain percentage of foreclosed homes for cash were removed, what do you think would really happen? Do you really think that the percentage of vendee loans would increase? Realistically, what do you believe to be the optimum cash/vendee percentage?

Answer: If the artificial limitation on vendee financing was removed, the VA would be able to dispose of its properties in a more businesslike manner. VA managers who are familiar with local real estate markets would be able to offer houses for sale with or without financing depending upon which would return the highest price. The current limitation removes the flexibility which is essential for the orderly disposal of property.

There is no optimum percentage of cash vs. vendee financing. Local VA managers should be concerned with obtaining the highest price possible, not whether they are exceeding a congressionally mandated percentage. If vendee financing is necessary to achieve this objective, then they should have the authority to offer such financing. Vendee loans can be converted to cash in the future when market conditions exist which would bring a high rate of return.

2. Question: Do you think it would be prudent for the VA to hold onto their loan portfolio for long-term gain?

Answer: The loan portfolio (vendee loans) should be disposed of whenever market conditions exist which would result in the highest return. Currently OMB policy requires that VA sell its loans almost as soon as they are originated. VA should have the flexibility to sell loans when it can realize marketing gains. For example, if VA has a large number of loans in its portfolio at nine percent and the current market rate is eight percent, it should sell the loans because they could be sold at a premium. When conditions change and the current market rate is ten percent, the nine percent loans would have to be sold at a discount. VA should be allowed to keep these loans, collect payments and, of course, interest.

A further drain on the Revolving Fund is caused by OMB's policy that loans be sold without recourse. Without VA backing, vendee loans are not eligible for inclusion in GNMA pools. Without the GNMA guarantee the buyers of vendee loans deeply discount the price they are willing to pay for these loans.

3. Question: You mention inadequate VA staffing levels. What level do you think would be appropriate?

Answer: VA's Loan Guaranty field staffing levels are grossly inadequate. Throughout most of the 1980s, staffing levels have remained stable during a time when workloads have increased substantially. For example, in Fiscal Year (FY) 1987 there were three more staff positions assigned to the Loan Guaranty Divisions than in FY 1981. However, during the same period of

time, loan applications increased 166 percent; foreclosures processed increased 181 percent; and property inventory increased 97 percent.

It may be helpful to look at a couple of specific regional offices to explain the seriousness of this situation. At the Houston Regional Office in FY 1981, 118 full-time personnel were assigned to the Loan Guaranty Divisions. At the end of the FY 1987, the same 118 positions were assigned. However, the property inventory increased from 392 to 5,449, a 1,400 percent increase. Also, loan volume increased from 14,209 to 18,657 and foreclosures processed from 473 to 6,518.

The St. Petersburg Regional Office is another case in point. In 1981, the employment number was 145; in FY 1987 it was 107. However, property inventory increased in the same time period from 273 to 515; loan volume increased from 12,300 to 33,418; and foreclosures processed increased from 347 to 1,250.

The VA can provide information which shows that similar situations exist in many regional offices. Unless the staffing deficiencies are addressed soon, the system will shut down. Serious morale problems will develop if employees are unable to see an end to the overloaded conditions. The use of overtime becomes counterproductive in the long run, as employees end up doing the same amount of work but put in longer hours. Further, serious doubts exist about the quality of the work being performed when such a serious understaffing situation exists.

In addition to a minimum allocation of 300 - 400 additional employees for the loan program, the VA must look very closely at its resource allocation system which allows regional office directors to assign employees to Divisions within the regional offices, often contracy to the wishes of the Congress. My view is that Central Office officials must direct the assignment of resources to the loan divisions. This is the only way there can be assurance that staff assignments are made as intended.

4. Question: During the past year you have been involved with the mortgage banking end of the business. In your personal view, should this program be self sustaining, and if so, I would be very interested to hear your specific recommendations.

Answer: About a year ago the VA celebrated the closing of the 12 millionth VA guaranteed loan. I had the opportunity to witness this veteran and his young family from Phoenix, Arizona, move into his first home. The sense of pride that was felt by all who contributed in some way to the process that allowed this veteran and all those who went before him is difficult to describe. With his VA guaranteed loan, this veteran received an acknowledgement from his country that his contribution was appreciated and noted. His country was saying good luck in the future; here's a helping hand in buying a home.

Any diminution in this very worthwhile and successful program would send the wrong signal to America's veterans. Any effort to increase fees or make the program self supporting would be ill advised. A better course of action is for the Congress and the Administration to make a clear statement that this program will be supported in all aspects in the future. Current problems should be acknowledged, but it also should be recognized that they are temporary.

In addition to making a clear statement of support and providing a proper funding level, Congress could benefit this program by allowing additional program enhancements. There are a number of new loan types currently being offered in the conventional market, such as ARMs, convertible ARMs, bi-weekly mortgages, and reverse annuity mortgages. If the VA had the authority to guarantee these types of loan products, it would boost the image and morale of the program. In addition, it would increase revenue to the Revolving Fund because loan volume would increase. MBA would be pleased to work with Congress on developing new loan products for the VA.

A dark cloud currently hanging over the program is the no-bid situation. The number of no-bids as a percentage of foreclosures continues to increase. Some lenders who were active VA lenders now decline to offer VA financing. VA's market as compared with FHA's is declining. MBA has heard reports that purchasers of loan portfolios price their offers lower if an excessive number of VA loans are included in an offering. MBA has also learned that GNMA is considering limiting the number of VA loans which can be included in a GNMA guaranteed pool because of the potential liability caused by no-bids. A GNMA issuer in Oklahoma has gone out of business and turned their servicing back to GNMA because of VA no-bids. This is obviously a situation which must be addressed soon if permanent damage to the program is to be avoided.

National Association of Home Builders

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Telex 89-2600 (202) 822-0500 (800) 368-5242

Martin Perlman
Vice President/Treasurer

Reply to:
Perl Homes, Inc.
10555 NW Freeway, Suite 131
Houston, TX 77092

APR 1 ~ 1988

April 7, 1988

The Honorable Marcy Kaptur, Chairwoman
Subcommittee on Housing and Memorial Affairs
Committee on Veterans Affairs
U.S. House of Representatives
Washington, D.C. 20515

Dear Madam Chairwoman:

It was a pleasure to testify before the Subcommittee on March 17, 1988. I hope that my additional comments on the renting of foreclosed properties will be of assistance as you continue your deliberations on solvency in the VA Home Loan Guaranty Program.

As I stated in my testimony I feel that renting foreclosed properties is an effective response to the alternative of "dumping" VA properties on a depressed market. The VA's property disposition policy only increases the existing foreclosure problem adding to an already extensive inventory in areas of economic downturn. You have the dual problem of the veteran who loses his home because of sharp reductions in his salary or unemployment and the "domino" effect when this veteran's property is subsequently sold at an auction below market prices. The veteran living next door or in the surrounding area would certainly consider walking away from a property which is only worth 50% of its original value due to the VA's "dumping" practices. This creates a "domino" effect which exacerbates the foreclosure problem.

Attached is my response to your two follow-up questions from the hearing. In general I feel that properties can easily be rented through a qualified management company. Additionally, renting properties with the option to buy would be an added tool to help families obtain homeownership while keeping property values near market rates.

Thank you for your continued leadership in seeking solutions to resolve solvency problems in the VA Home Loan Guaranty Program. I hope that my comments will be of assistance and that you will contact me again if I might be of further assistance.

Sincerely yours,

Martin Perlman
Vice President and Treasurer

QUESTIONS & ANSWERS

Response by Martin Perlman, Vice President and Treasurer, of the National Association of Home Builders from Houston, Texas, to questions submitted by the House VA Subcommittee on Housing and Memorial Affairs. These questions are in follow-up to hearings held on March 17, 1988, concerning solvency in the VA Home Loan Guaranty Program.

1) HOW EASY DO YOU THINK IT WILL BE FOR FORECLOSED PROPERTIES TO BE RENTED AND HOW DO YOU ENVISION THIS WORKING?

First, I feel that there is a market for foreclosed homes which could be rented to people who cannot afford to buy due to economic or credit problems. This has the possibility of providing rental housing for families on a lower social and economic scale with a free standing house in a better neighborhood. As I mentioned in my statement, I had no trouble renting Perl homes which I could not sell due to the VA's "dumping" practices.

Second, I envision this working on a relatively simple basis. The rent coming in would cover the debt service on the house and the builder's equity would remain intact as he wouldn't have to sell the home at a substantial loss.

The home could be leased to a needy tenant for a year with a renewable option to extend the lease if mutually agreed to by the parties involved. This could be handled by engaging a reputable real estate property manager who would handle the leasing and everyday management of the property. It is imperative that a qualified management leasing agency be found which is highly motivated. In the past vandalism has occurred where management companies were not adequately screened.

2. HAVE YOU EVER CONSIDERED THE IDEA OF RENTING PROPERTIES WITH THE OPTION TO BUY?

I feel that renting properties with the option to buy is a viable alternative. Everyone wants to buy a home for their family and this would be a means to provide for that possibility. It is workable based on the criteria that the buyer would have to meet standard qualifications for the purchase. It is even more viable if a portion of the rent is applied toward a reduction in the cost of the home.

The Subcommittee may want to consider trying this on a demonstration basis in economically depressed areas. It would be a positive step in assisting families to become homeowners and in counteracting the VA's property disposition policy which has had the effect of severely lowering home values.

Manufactured Housing Institute
1745 Jefferson Davis Highway, Arlington, Virginia 22202/ (703)979-6620

May 10, 1988

The Honorable Marcy Kaptur, Chairwoman
Subcommittee on Housing and Memorial Affairs
U. S. House of Representatives Committee on
Veterans Affairs
335 Cannon House Office Building
Washington, D.C. 20515

Dear Congresswoman Kaptur:

Thank you again for the opportunity to offer our comments at your March 17, 1988 hearing. I am enclosing answers to the follow up questions you posed to the Manufactured Housing Institute.

I hope to provide you with more detail on question 1 about foreclosure rates for the period 1979 through 1987. We have requested the assistance of one of our members and are hopeful that they will be able to provide some information soon. In the meantime, we are providing the information we have on file.

I hope that the data we have provided is useful to you in your evaluation of the VA Home Loan Guaranty Program. We certainly support you in your efforts to keep this valuable program available to America's veterans.

Sincerely,

Jerry C. Connors
President

Enclosure

ANSWERS TO THE QUESTIONS OF THE HONORABLE MARCY KAPTUR FROM JERRY CONNORS, MANUFACTURED HOUSING INSTITUTE FOR THE SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS HEARING MARCH 17, 1988

Question 1: Your testimony provides statistics on the comparison between site-built homes and manufactured homes. Specifically you discuss the period 1984-1987. Could you please provide us with the foreclosure rates associated with loans closed during this period? Also, for the period 1979-1983?

Most of the information that we provided in our written testimony was obtained from the Veterans Administration in connection with an internal study they did of the manufactured home loan guaranty program several years ago. We thought the similarity in foreclosure rates on manufactured homes and site-built homes in the same price and downpayment range was a revealing piece of information. Lower income families with little equity in their homes have a higher incidence of default regardless of the type of construction used to build the home.

Information that we have on hand comes from our annual survey on manufactured home financing that we did up until 1985. That survey posed questions on delinquent loans and foreclosed loans. Here is a summary of the results of the survey on those questions for 1979-1985.

SELECTED MHI FINANCE SURVEY RESULTS

1979	1980	1981	1982	1983	1984	1985
PERCENT OF LOANS PAID OFF BY REPOSSESSION DURING YEAR:						
2.2%	1.9%	2.1%	2.2%	2.7%	2.9%	2.7%
PERCENT OF LOANS 30 OR MORE DAYS DELINQUENT AT YEAR END:						
3.4%	3.0%	4.3%	4.7%	4.6%	4.9%	4.8%
REPOSSESSIONS ON HAND OR IN PROCESS AT YEAR END AS A PERCENT OF LOANS OUTSTANDING:						
0.5%	0.5%	0.8%	0.9%	1.2%	1.3%	1.4%

Question 2: Statistics show that approximately 50 percent of the manufactured housing activity during fiscal year 1987 was active duty service personnel. Do you believe the needs of active duty servicemen as they relate to manufactured housing could better be served in another branch of the government.

We do not believe that another branch of the government would better serve active duty service personnel in administering the manufactured home loan guaranty program. We do not believe that problems with the solvency of the program are related to administration, but are the result of economic events over which the VA, lenders and consumers had little control. It would seem a duplication of effort and costs to have the program administered by two different agencies.

National Council of
Savings Institutions
James J. Butera
Group Vice President for
Legislative and Regulatory Policy

May 16, 1988

The Honorable Marcy Kaptur, Chairwoman
Veterans' Affairs Subcommittee on Housing
and Memorial Affairs
United States House of Representatives
Washington, D.C. 20515

Dear Congresswoman Kaptur:

The National Council of Savings Institutions would like to respond to your question on whether lenders rent properties from their foreclosed inventory.

The National Council's testimony presented before the Subcommittee on Housing and Memorial Affairs pointed out that because the Veterans' Administration's REO disposition program requires no downpayment, buyers under the program closely resemble renters. We, therefore, suggested that the Veterans' Administration consider renting foreclosed properties until they can be sold at more attractive prices than currently possible through auction.

This leasing concept is based on the common practice by private lenders holding REO inventories in depressed economies, such as the oil belt states. For these lenders, disposing of an entire inventory of foreclosed property is not a financially sound or viable solution, especially in saturated real estate markets. Leasing, however, provides an alternative to sale that generates income from a previously nonperforming asset.

Benefits of Leasing REO

The National Council believes that the VA would benefit from following a similar leasing practice. In so doing, the VA could recover a larger portion of its original investment and reverse the deflationary effect VA wholesale auctions have had on real estate values. Below are other keys benefits of leasing:

The lease agreement creates an important lender-renter relationship which often leads to the sale of the property. In fact, statistics show that 35-50% of renters can be converted to purchasers. REO holders can entice renters to buy properties by offering certain incentives. For example, some lenders apply the rental payments toward a downpayment, others reduce the downpayment by 6% of the sales price--or the amount saved on real estate brokerage fees.

Experience has shown that renters take better care of rental property if they have an option to purchase. Maintenance for unoccupied properties can be the most costly item for holders of REO. Routine maintenance can multiply into serious conditions if no one is present to detect a problem. Abandoned properties are also more susceptible to vandalism and damage resulting in costly and time consuming repairs which can delay or ruin a sale.

The leasing arrangement gives the lender a perfect opportunity to establish a case history on the potential borrower's creditworthiness and future ability to make mortgage payments.

It must be stressed again that the VA's current auction policy is seriously damaging real estate prices. By leasing the properties--instead of precipitously auctioning them--the VA would not only minimize its losses but create a stabilizing force in a troubled marketplace. We were concerned about the VA's testimony at your recent hearing which indicated a general policy of reducing prices on REO by 25% in order to dispose of them quickly.

Important Cost Considerations

In order to maximize returns and minimize the costs of leasing foreclosed property, it is important to consider whether REO is best managed internally or through an asset management company. Most lenders, especially those with large REO inventories, find it necessary to hire an outside company to maintain, market and analyze their REO portfolio.

Using an outside management company has several advantages. One such advantage is that lenders, for example, need not hire large staffs to handle REO. This in turn reduces salary expenses. Because outside REO management companies are specialized, they have the latest computer technology designed to track maintenance, analyze market conditions, explore sales potentials, report leasing proceeds, etc. In addition, these companies have the marketing and sale expertise needed to optimize returns on the eventual sale of properties. For national lenders, such as the VA, it is important to consider hiring one national company that can handle an entire REO portfolio. This will avoid confusion and complexity.

Outside management companies have several ways of pricing their services. Some companies charge 5-6% of total monthly rental fees collected, others charge flat fees or a combination of both.

Volume of REO

Unfortunately, because most private and government lenders keep their REO volume confidential, it is difficult to collect data on the number of leased REO properties. The National Council is currently researching this information and we should be able to provide figures on certain localized markets in the near future.

We hope this information is of value to your efforts regarding the VA's Home Loan Guarantee Program. Please contact us again if additional material is needed.

Sincerely,

James J. Butera/RAP

James J. Butera

UNIVERSITY OF CALIFORNIA, BERKELEY

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PREPARED STATEMENT OF
DR. ROBERT H. EDELSTEIN
Professor, Business Administration,
Chair, Real Estate Faculty Group, and
Co-Chairman, Center for Real Estate and Urban Economics,
University of California at Berkeley

Before the

Subcommittee on Housing and Memorial Affairs of the
House Committee on Veteran Affairs
Concerning the VA Loan Guaranty Program
March 17, 1988

Madam Chairwoman and Members of the Sub-Committee:

I would like to thank you for this opportunity to present my views about the problems and potential solutions for the Veterans' Administration (VA) Home Loan Guaranty Program. I will divide my comments into three parts:

* First, I will discuss how changes in market conditions have combined with the structure of the loan program to engender a continuing and expanding fiscal problem for the VA Loan Program.

* Second, I shall propose an alternative program that, I believe, will generate, in the long-run, an economically viable VA Loan Guaranty Program.

* Third, I will examine schematically how improved management efficiency would help the VA Loan Program, but is unlikely by itself to solve its fiscal plight.

I - What Causes the VA Loan Program Losses?

Historically, the VA Loan Program has been the best of two worlds: a program with significant entitlements that supported the objective of providing funding to veterans for purchasing homes and, simultaneously, did not create a fiscal burden for taxpayers. While the VA Loan Guaranty Program is still a valuable entitlement program to veterans, in recent times, the VA Loan Guaranty Program has become (and is likely to remain) expensive to maintain in its current form because of growing loan defaults and foreclosures. Tables 1, 2 and 3 suggest the causes as well as the magnitudes of the VA Home Loan Program fiscal problems. Table 1 shows the number, characteristics, and performance of loans guaranteed under the Veterans' Administration Home Loan Programs from fiscal year 1972 through 1986. First, the average loan interest rates between 1980 and 1985 are significantly higher than in other years before or after. This caused fewer loans to be issued, as one would expect; and resulted in a foreclosure rate as of September 1987 that is three to five times higher than would be expected from earlier historical experience.

Table 2 showed loan foreclosures by original loan date versus the termination date for loans issued during fiscal years 1980 through 1984. From this data, and abstracting from a major future change in the economic environment, one would expect that the foreclosure rates observed for 1983 and 1984 loans have not fully matured; that is, one might anticipate that significantly more terminations (foreclosures) will occur. Given the historical experience, one might expect loans originated in fiscal year 1983 or 1984 to achieve ultimate claim rates in the 10-20% range of total loans originated. In other words, the worst may not be over in terms of foreclosures that the VA Loan Programs will experience.

Table 3 subdivides delinquent loans (i.e., loans in default or if the claim is pending) by year and originating regional office. From this table, one can observe that there are regional as well as temporal loan default differences. In general, the delinquency rate has been rising during the 1980's. However, certain regional markets, characterized by the oil patch and agricultural belt, are experiencing significantly higher than average delinquency rates. It has been argued, and I believe correctly, that the driving force behind defaults ultimately is the economic health of the regional real estate market. Table 3 certainly is consistent with that notion.

In summary, the VA Loan Guaranty Program provides low or no down-payment loans (as an entitlement to veterans). These types of loans are intrinsically risky, and are likely to have higher than average default rates when compared with conventional mortgage loans. Unfortunately, in the volatile economic markets of the 1980's, where certain regional markets for real estate have become depressed, the increased VA foreclosure-default experience is easy to understand in retrospect. This raises the fundamental question: Can we have the existing levels of entitlement without engendering fiscal burdens on the Loan Guaranty Fund?

II - Is There An Alternative Program That Maintains Entitlements Without Fiscal Grief?

If the objectives of the Veterans' Administration Loan Guaranty Program are to maintain entitlements and not require long run external subsidies, new methods for financing the Loan Guaranty Fund will be necessary. While the VA can make changes to its program to reduce costs to the government by, say, removing some of the valuable entitlement features of the program for example, -- increasing down-payments or increasing fee structures -- is there another way to maintain the existing benefit structure? It is undeniable that the most important entitlement feature of the VA Loan Program is the "no money down" (i.e., 100% financing) of home loans. Approximately two-thirds of the VA loans are originated with no buyer equity in the property. Even recently, many veterans have received the benefit of a no down payment home purchase and ultimately ended up, several years later, with significant growth in real estate equity. Unfortunately, more recently, many veterans in the Loan Guaranty Program have found that property value disinflation has created a loan liability that is significantly greater than the subsequent property value. The first group of veterans are truly economic winners; and the second group of veterans are economic losers.

Given these circumstances, I propose a simple system which would:

* Maintain entitlements at current levels, if so desired; and

* Become self-funding in the long-run by developing a set of ex-post fees based upon the level of benefits the loan program has produced for each participant.

Briefly, under my proposal, if a veteran under the Loan Guaranty Program accumulates net equity, when he transfers, sells, or re-finances his property, he would "share" a pre-determined percentage of his equity gain with the Loan Guaranty Program. (Losers would not necessarily be required to pay

anything.) In this way, participants who have accumulated net equity, because their property values increased, would return money to the program in direct proportion to the level of their gains.

A hypothetical numerical example will illustrate how this would work. Assume a VA Guaranty loan is used to 100% finance the purchase of a $100,000 house (including all costs and expenses of home purchase). Thus, the original basis for determining equity build-up over time would be $100,000. After several years, assume that the veteran sells his home for $170,000 (net after expenses and commissions). In essence, the veteran has gained $70,000 in net equity. If the equity sharing percentage between the veteran and the Loan Fund were, say, 10%, the veteran would transfer at sale $7,000 of his $70,000 gain to the VA Loan Program.

These funds would then be available to pay for expenses of the Loan Program operation, including default-foreclosure expenses. Someone whose net equity build-up were zero (or less) would not be expected to pay into the program upon foreclosure, sale and/or transfer of the property. In other words, the Loan Program economic winners would share their gains, and indirectly compensate for the losers "bad luck" in the real estate market. (Obviously, the proper calibration of the ex post percentage fee structure in order to achieve the Loan Fund self-sufficiency requires special attention. To determine the correct percentage fee structure would require careful research and analysis of historical VA loan experience.)

This proposal does not have to be implemented exclusively, but could be combined with existing or proposed plans for the Loan Program. By way of illustration, I would suggest that the amount of ex post sharing could vary depending upon the amount of down-payment associated with the loan and/or the amount of "up-front" fees paid by the borrower. For example, if someone were to take out a 90% loan instead of a 100% loan, they would

be required to share 2% of their net equity 5instead of 10% in the example. If the borrower were willing to pay a significant "up-front" fee into the Loan Guaranty Fund, then he might have to pay 0% of his net equity build-up, as under the current system. In essence, I view my proposal as an important addition to the menu of options that could be made available to the veteran.

Finally, the a priori choice of who will be "winners" and who will be "losers" in the Loan Program is influenced strongly by regional economic performance. It does not take much imagination to understand that in the early 1970's one would have "guessed" that borrowers in Houston would have little difficulty in being able to repay their loans because of the significant property appreciation that was being experienced. On the other hand, borrowers in New England in the early 1970's were finding regional economic limitations which caused property markets to lag behind other parts of the country. In the 1980's, regional economic performances shifted dramatically. Those places that would have been perceived as having the bulk of net gainers under the Loan Program would have produced many more net losers than had been anticipated. My proposal for ex post sharing charges the winners after they have won, and does not penalize those who were default and ultimately become economic losers.

III. How Important Is The Management of the Loan Program To Its Success?

Good management of the Loan Guaranty Program and attendant services is crucial to the success of the VA Loan Guaranty Program. First, if my type of proposal or any other fee structure is to work, the calibration of the fee structure in order to engender fiscal viability is not trivial. This issue is thorny, and requires significant research and analysis.

Second, the administration, in processing of loan applications, appears that it can be upgraded. There has been a great deal of press coverage dealing with appraisal problems.

Obviously in a 100% loan business, there is no margin for error in terms of understanding value. Proper administration at this level is essential.

Third, much attention has been given to the recent performance of private mortgage insurers. Private mortgage insurers have become significantly more prudent in underwriting, an option if followed by the VA which would result in reduction of entitlements. Assuming that entitlements are to be maintained, it is clear that better monitoring, guidance, and counselling of borrowers would tend to mitigate foreclosure-default losses.

Fourth, it appears that the disposition of VA foreclosed properties in economically distressed regions has probably exacerbated the circumstances for the VA as well as other real estate owners, especially lending institutions with REO (real estate owned). To the extent that the VA has "dumped" real estate into local regional markets it has driven property values lower than they might have been. Mandatory selling of properties, without regard for the impact upon the property value market, will result in lower overall yields to the Veterans' Administration, and intensify losses suffered by the Government. On a local market by local market basis, when the VA owns significant quantities of real estate, it should carefully study how the markets may perform over time, and in some instances develop an ownership-landlord-rental strategy, (i.e., hold - not sell). Also, if the VA sells properties, it might sell them with a participation in future equity growth.

Finally, it has been suggested that the government sell VA loans without recourse. This appears to me to be patently silly. If the loans it attempts to sell are high risk loans or loans in default, it will receive only pennies on the dollar for such loan sales activities. Part of the reason for the success of the GNMA (Government National Mortgage Association) mortgage backed security programs has been the use of the Guaranty. It is myopic and economically self-defeating to attempt to sell either whole loans or loans in the forms of pools for mortgage backed securities without the Guaranty.

In summary, I believe that the entitlement program can be kept in place with the ex post beneficiaries of the Loan Guaranty Program paying with minimal economic pain for the significant benefits generated for them by the program. My proposal for ex post net equity sharing represents a long run vehicle by which the VA Loan Program may again become economically self-sufficient. Simultaneously, improved program efficiency can be achieved through careful management of its operation at the loan origination stage, foreclose-default counselling stage, and property management-disposition stage; but by itself efficient management will not solve the VA Loan Guaranty Fund's fiscal problems.

TABLE 1

VETERANS' ADMINISTRATION
FISCAL YEAR HOME LOAN DATA
NUMBER/PERCENTAGES OF LOAN OUTSTANDING, PAID IN FULL, AND FORECLOSED
AS OF END OF MONTH SEPTEMBER 1987

FISCAL YEAR	TOTAL NUMBER* OF LOANS GUARANTEED	AVERAGE LOAN INTEREST RATE	LOANS OUTSTANDING NUMBER	LOANS OUTSTANDING RATE	PAID IN FULL	FORECLOSURES RATE
1986	416,295	9.86%	401,929	96.5%	3.3%	0.1%
1985	208,751	11.99%	141,031	67.6%	30.2%	2.2%
1984	182,669	12.82%	91,954	50.3%	43.0%	6.7%
1983	300,427	12.11%	170,559	56.8%	36.7%	6.5%
1982	97,136	14.94%	24,927	25.7%	59.3%	15.1%
1981	154,741	13.73%	59.805	38.6%	44.3%	17.0%
1980	263,964	11.45%	170,602	64.6%	24.1%	11.3%
1979	371,211	9.68%	297,627	80.2%	13.4%	6.4%
1978	372,910	8.80%	290,508	77.9%	17.8%	4.3%
1977	394,277	8.21%	283,455	71.9%	24.8%	3.3%
1976	333,989	8.60%	203,881	61.0%	34.8%	4.1%
1975	299,522	8.50%	167,619	56.0%	38.9%	5.1%
1974	304,737	8.51%	151,836	49.8%	43.8%	6.3%
1973	307,897	7.18%	161,436	52.4%	42.7%	4.9%
1972	353,405	7.00%	175,708	49.7%	49.5%	4.4%
TOTAL	4,361,931	-	2,792,877	-	-	-

*BASED ON DATE OF LOAN

SOURCE: VETERANS' ADMINISTRATION

TABLE 2

VETERANS' ADMINISTRATION
FISCAL YEARS 1980-1984
LOAN FORECLOSURES BASED ON LOAN DATE VS. TERMINATION DATE
AS OF END OF MONTH JUNE 1987

FISCAL YEAR ORIGINATED	FISCAL YEAR TERMINATED								ACTIVE WITH PARTIAL CLAIM	TOTALS	CLAIMS AS % OF ORIGINATIONS
	THROUGH JUNE 1987	1986	1985	1984	1983	1982	1981	1980			
1984	4,773	4,317	1,001	11					10	10,112	5.54%
1983	5,321	6,414	4,503	929	10				14	17,191	5.73%
1982	2,092	3,315	3,747	3,571	1,191	31			6	13,953	14.37%
1981	2,677	4,089	5,342	6,189	5,409	1,653	34		4	25,397	16.42%
1980	2,932	3,872	4,451	5,260	5,343	4,653	2,031	43	5	28,590	10.83%

SOURCE: VETERANS' ADMINISTRATION

TABLE 3

VETERANS' ADMINISTRATION
GUARANTEED OR INSURED HOME LOANS, BY YEAR AND BY SELECTED
REGIONAL OFFICE, IN DELINQUENCY* (AS PER CENT TOTAL
NUMBER OF LOANS OUTSTANDING

REGIONAL OFFICE	1987	1986	1983	1980	1977
BOSTON	2.1	2.1	2.1	2.1	2.2
NEW YORK	2.2	2.2	2.1	1.9	1.5
ST. PETERSBURG	6.7	6.9	7.0	7.2	7.6
CLEVELAND	6.9	6.8	5.8	4.8	4.3
DENVER	4.9	4.1	3.4	3.2	3.6
SAN FRANCISCO	2.4	2.4	2.3	2.3	2.4
LOS ANGELES	4.7	4.7	4.3	4.2	4.6
WACO	5.5	5.3	5.2	5.3	6.4
MUSKOGEE	5.5	4.9	4.1	4.1	4.5
HOUSTON	8.2	7.1	5.7	5.7	6.4
NATIONAL AVERAGE	4.5	4.3	3.9	3.6	3.6

*LOANS IN DEFAULT AND CLAIMS PENDING

SOURCE: VETERANS' ADMINISTRATION